SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-971

D. C. TRANSIT SYSTEM, INC., *Petitioner*

v.

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA,
BLACK UNITED FRONT,
WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

E. BARRETT PRETTYMAN, JR.
SAMUEL R. BERGER
815 Connecticut Avenue, N.W.
Washington, D.C. 20006
Attorneys for Petitioner

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner respectfully prays that a writ of certiorari issue to review the opinions and judgments of the United States Court of Appeals for the District of Columbia Circuit, rendered on June 28, 1973, in *Democratic Central Committee of the District of Columbia, et al.* v. *Washington Metropolitan Area Transit Commission,* No. 21,865 (D.C. Cir., June 28, 1973), *Democratic Central Committee of the District of Columbia, et al.* v. *Washington Metropolitan Area Tran-*

sit Commission, No. 24,398 (D.C. Cir., June 28, 1973), and *Black United Front* v. *Washington Metropolitan Area Transit Commission,* No. 24,428 (D.C. Cir., June 28, 1973). Petitioner was an Intervenor in those cases.

OPINIONS BELOW

The opinions of the Court of Appeals, which are not yet reported, are printed as Appendices A and B to this Petition. The Court of Appeals' denial of Intervenor's Petition for Rehearing and Suggestion for Rehearing En Banc is not reported but is printed as Appendix C to this Petition.

JURISDICTION

The opinions of the United States Court of Appeals for the District of Columbia Circuit were rendered on June 28, 1973. Intervenor's Petition for Rehearing and Suggestion for Rehearing En Banc was timely filed on August 27, 1973, and denied by the Court of Appeals on September 24, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Does denying to the owners of a utility's land the growth in value of that land deprive them of property without due process of law, or constitute a "taking" of property for public use without just compensation in violation of the Fifth Amendment to the United States Constitution?

2. When a court retroactively reverses a utility commission's consistently applied treatment of land appreciation, recalculates the utility's income for all prior years based upon the court's new rule, and applies the recalculated income to the future, does the court violate

the utility's guarantees of procedural due process in violation of the Fifth Amendment to the United States Constitution?

3. By overturning the long-established accounting practice of a regulatory commission, which practice is universally accepted in public utility regulation and consistent with all legal precedent, has the United States Court of Appeals for the District of Columbia Circuit exceeded the legitimate scope of its reviewing authority?

CONSTITUTIONAL PROVISION INVOLVED

The Fifth Amendment to the United States Constitution provides in pertinent part:

> * * * nor [shall any person] be deprived of * * * property, without due process of law; nor shall private property be taken for public use, without just compensation.

STATEMENT OF THE CASE

These cases arose as appeals to the United States Court of Appeals for the District of Columbia Circuit of two orders—one issued in 1968 and one in 1970—by the Washington Metropolitan Area Transit Commission (hereinafter, the Commission). On these appeals, a three-judge panel of the Court of Appeals, with one judge dissenting, held, *inter alia,* that the Commission's long-standing and universally accepted practice of recognizing that growth in the value of a utility's land belongs to its investors was "irrational" (App. 71a). The panel majority held that capital gains on land belong, not to a utility's investors, but to its ratepayers. Therefore, according to the court, a public utility's rates should be decreased —dollar for dollar—by the amount of appreciation in

its land once it is sold or simply transferred to non-operating status. Moreover, the court applied a new principle of retroactivity to utilities, recalculating the income of the utility for all prior years on the basis of the new rule on capital gains and applying the difference as future income.

In 1956, Petitioner D. C. Transit System, Inc. (hereinafter, Transit) was awarded a franchise to operate a mass transportation system within the Washington metropolitan area, and soon thereafter Transit acquired the assets of the existing transit system.[1] The parcels of land upon which this litigation centers were a part of that 1956 acquisition.[2]

From time to time between 1956 and 1968 (the date of the first Commission order here involved), various parcels of land employed by Transit in its mass transit operations lost their usefulness for those purposes. In accordance with procedures consistently prescribed by the Commission and its predecessor,[3] Transit accounted for this loss of usefulness by transferring the parcels on its books from operating to non-operating

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[1] Pub. L. No. 84-757, 70 Stat. 598 (1956).

[2] The Court of Appeals' opinions and judgments cover both depreciable properties (*i.e.*, buildings) and non-depreciable properties (*i.e.*, land). Although Transit disagrees strongly with the court's treatment of depreciable properties, it raises in this Petition only the court's treatment of land.

[3] The Washington Metropolitan Area Transit Commission was created in 1960 and succeeded the District of Columbia Public Utility Commission (hereinafter, PUC). *See* Washington Metropolitan Area Transit Regulation Compact (hereinafter, Compact), tit. I, art. II, incorporated into Pub. L. No. 86-794, 74 Stat. 1031 (1960), set forth following D.C. Code § 1-1410 (1973). The practice of both the PUC and the Commission regarding treatment of appreciation on land has been the same. *See* pp. 16-17, *infra*.

status (in accounting terms, transferring them "below the line"). If a parcel were subsequently sold, any gain was credited to the investors. During this period, the Commission issued numerous rate orders applying to Transit, in the process of which this practice was repeatedly approved, either explicitly [4] or implicitly. [5]

In late 1967, Transit applied for a rate increase which, after public hearings and a thorough review of Transit's operations, was partially granted by the Commission. [6] A petition for rehearing was denied by the Commission, [7] whereupon Appeal No. 21,865 was filed with the Court of Appeals for review of that 1968 Commission order.

In 1970, Transit applied for an additional fare increase. Upon review, the Commission granted the increase [8] and subsequently denied a petition for rehearing, [9] whereupon Appeal Nos. 24,398 and 24,428 were filed with the Court of Appeals for review of the 1970 Commission order.

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[4] *See* pp. 16-17, *infra*.

[5] The Commission is given broad powers to review and alter, on its own initiative, any practice of Transit which affects fares and which is unjust or unreasonable. Compact, tit. II, art. XII, § 6.

[6] *D. C. Transit System, Inc.* (Order No. 773), 72 P.U.R.3d 113 (WMATC 1968).

[7] *D. C. Transit System, Inc.* (Order No. 781) (WMATC Feb. 26, 1968) (unreported); *D. C. Transit System, Inc.* (Order No. 781a) 74 P.U.R.3d 178 (WMATC 1968).

[8] *D. C. Transit System, Inc.* (Order No. 1052) 85 P.U.R.3d 1 (WMATC 1970).

[9] *D. C. Transit System, Inc.* (Order No. 1057) 85 P.U.R.3d 33 (WMATC 1970).

The individual and organizational Respondents asserted below that the two Commission orders were invalid because, *inter alia,* the Commission had failed to recognize that income was "realized" when these parcels of land were transferred "below the line" and that this income—measured by the difference between the cost of the land to Transit and its fair market value when transferred—belonged to the farepayers. Accordingly, these Respondents claimed that the fares set by the Commission should have been decreased by that amount.

The panel majority of the Court of Appeals concurred with this view. It rejected what it acknowledged was the long-standing practice of the Commission,[10] and held that growth in the value of land while in service should be credited to farepayers and not to the 7000 shareholders of Transit's parent. It took the position that, although at one time investors may have had a constitutionally-protected interest in the growth in value of their property, more recent decisions of this Court indicate that they no longer have such protection (App. 27a).

The panel majority applied its new rule with retroactive effect. It held not only that farepayers were entitled to the appreciation on parcels that had been transferred while the two orders now deemed invalid were in effect, but that they were also entitled to the growth in value while in service of all the parcels of land that had been transferred to non-operating status since Transit commenced business in 1956.

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[10] The Court of Appeals stated that: "The decisions within the District—all administrative—have reached a uniform result * * *" (App. 17a). "[T]he administrative decisions * * * have uniformly viewed such gains as belonging to Transit's investors * * *" (App. 23a).

Since Transit's operations, subsequent to the two Commission orders under review, had been publicly assumed,[11] the panel majority ordered Transit to make total restitution to the farepayers and remanded to the Commission to determine the amount and method of that restitution.

Judge MacKinnon dissented from the majority's "wholly unprecedented" treatment of land, and warned of its "dangerous" implications (App. 121a, 95a). The majority, he said "blithely concludes without close analysis" that the principles which apply to *depreciable* assets also apply to *non-depreciable* assets, and it engages in a "procrustean attempt" to force the latter into the former's mold (App. 94a, 99a). Moreover, Judge MacKinnon took the position that administrative accounting, where consistently applied, "should not be the subject of *de novo* judicial examination," which, he said, "violates fundamental notions of administrative law and the role of the judiciary" (App. 108a, 123a).

Transit's Petition for Rehearing and Suggestion for Rehearing En Banc to the Court of Appeals was denied on September 24, 1973 (App. C).

REASONS FOR GRANTING THE WRIT

These cases do not arise in ordinary times. There is no longer any serious dispute that this country faces shortages in our energy supplies of major proportions. The questions that remain are *how much* economic dislocation these shortages will cause, *how drastic* will be the measures of adjustment, and *how long* will it take to increase our supplies.

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[11] The National Capital Area Transit Act of 1972, Pub. L. No. 92-517, 86 Stat. 999 (1972).

To meet these substantial shortages, it has been estimated that the investor-owned electric utility industry must, in the next ten years, invest $205 billion in new plant and equipment,[12] that the natural gas industry must lay nearly a million miles of new gas pipeline over the next 20 years,[13] and that, in order to reach only 90% self-sufficiency by 1985, the total capital requirements for energy facilities will range from $451 billion to $547 billion.[14] It is clear that the vast bulk of this capital must be raised from the private sector.

In the face of these unparalleled demands on our public utilities, the Court of Appeals' decisions in the instant cases will have, in the words of the American Gas Association, which is comprised of approximately 300 natural gas companies serving 140 million Americans and supplying 92% of the nation's natural gas, "significant adverse consequences for future public utility financing."[15] For what the court essentially has held is that the rates that regulated public utility companies charge their customers must be decreased—dollar for dollar—by the growth in value of their land when it is removed from operating status. At the very best this is, in effect, a requirement that public utilities sell off all their non-operating land to make

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[12] *ELECTRICAL WORLD*, Vol. 179, No. 12, June 15, 1973, at p. 30.

[13] *AMERICAN GAS ASSOCIATION MONTHLY*, Vol. 55, No. 2, February 1973, at p. 13.

[14] *NATION'S BUSINESS*, Vol. 61, No. 10, October 1973, at pp. 76-77.

[15] Brief in the Court of Appeals for the American Gas Association as Amicus Curiae in Support of Petition for Rehearing and Suggestion for Rehearing En Banc at 2, *Democratic Central Committee* v. *WMATC*, No. 21,865, *Bebchick* v. *WMATC*, No. 23,720, *Democratic Central Committee* v. *WMATC*, No. 24,398, *Black United Front* v. *WMATC*, No. 24,428 (1973).

up this deficiency in rate income. This far-reaching step has been taken, not by a legislature or a regulatory agency after thorough analysis of its potential consequences to the industry and to the public, but by a court, acting without a single precedent and in disregard of universally applied administrative judgments to the contrary.

What is perhaps even worse, the court has fashioned a sweeping principle of retroactivity—reaching back more than decade and brushing aside numerous final administrative and judicial decrees in applying its new rule. For the court has said that in fixing rate orders in 1968 and 1970, the Commission should have considered as current income, available as an offset to future rates, amounts that—according to its own view—were earned as early as 1958.

If these opinions are permitted to stand, potential utility investors and creditors will be compelled to assume not only the risk that the "rules of the game" at the time of their investment may not have continuing application in the *future*—a factor that is already inherent in regulated utility investments—but also the risk that the financial picture of the utility at the time of their investment is subject to complete recalculation some time in the unlimited future. Potential utility investors and creditors currently rely upon the financial state of the utility as reflected in the sworn statements of its officers to the Securities and Exchange Commission, the annual reports, and the financial statements certified by reputable accountants. If the principle of retroactivity applied by the Court of Appeals is permitted to stand, however, these financial statements are subject to recalculation at any time in the future when a principle upon which they have been

based is reversed retroactively. That new element of uncertainty injected by the court into utility investment will be immediately and directly reflected in higher costs for utility capital and credit. As the American Gas Association has warned, the court's opinion will "very significantly decrease the ability of the natural gas industry to raise needed capital."[16] And that is no less true for the other utility industries.

Thus, these cases have significance for the country far in excess of the impact upon the immediate parties. If the result is a further depletion in the incentive of investors to commit their funds for research and expansion in the vitally important energy utilities, the decisions below are of incalculable importance.

I. Growth in the Value of Land Is an Intrinsic Part of the Land Itself, and To Deprive Its Owners of that Growth Is To Deprive Them of Property Without Due Process and To Take It Without Just Compensation.

The Court of Appeals has held that, in prescribing rate orders for 1968 and 1970, the Commission should have reduced rates by the amount of growth in Transit's land, measured at the time it was transferred to non-operating status. Prescribing rates is a legislative act,[17] and although it is an exercise of the police power,[18] a taking of property cannot escape the obligations of the Just Compensation Clause simply

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[16] Motion in the Court of Appeals by the American Gas Association for Leave to File Statement of Amicus Curiae in Support of Petition for Rehearing and Suggestion for Rehearing En Banc at 3 (Nos. 21,865, 23,720, 24,398, and 24,428).

[17] *Bluefield Water Works & Improvement Co.* v. *Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).

[18] *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 601 (1944).

because it is accomplished under the guise of rate-making. [19]

It has been long established that investors in a public utility own the utility's property, including its property dedicated to public use. As this Court said in *Board of Comm'rs* v. *New York Tel. Co.*, 271 U.S. 23 (1926):

> Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company, just as does that purchased out of proceeds of its bonds and stock. * * * [*Id.* at 31-32.]

It is equally true that property can be "taken", in the constitutional sense, without divesting the owner of the title thereto; property in land is "taken" whenever one of the privileges or incidences of which it is composed is taken. [20]

Indeed, the Court of Appeals conceded that at one time the case law supported the proposition that "utility assets, though dedicated to the public service, remain exclusively the property of the utility's investors, and that growth in value is an inseparable and inviolate incident of that property interest" (App. 27a). However, the court went on to conclude that those cases which abandoned the requirement that rates

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[19] 2 *Nichols on Eminent Domain* § 6.1 (3d ed. 1970).

[20] *United States* v. *General Motors Corp.*, 232 U.S. 373 (1945); *United States* v. *Causby*, 328 U.S. 256 (1946).

be based upon the fair market value of a utility's assets also overturned the established doctrine that growth in the value of utility property is an intrinsic element of the property which cannot be taken without just compensation (App. 27a-38a).

A closer look at the history of those cases, however, does not support the court's conclusion. Certainly, *FPC* v. *Hope Natural Gas Co., supra,* did destroy the pre-existing notion that appreciation in the value of utility property is a part of the cost of service for which ratepayers must pay. No longer are ratepayers required to pay a return on that appreciation as part of their charge for service, nor must they reimburse investors for that appreciation in the form of depreciation charges. They are required only to pay a return on the capital originally invested in the assets and to reimburse investors only for the *cost* of depreciable assets. But it by no means follows from that, as the Court of Appeals contended, that the ratepayers are entitled to the capital gain itself or that the incidence of ownership in the land, always recognized as residing with the investors, has in any way been affected by *Hope Natural Gas* or its progeny.

As Potomac Electric Power Company stated in its *Amicus Curiae* Brief in Support of Transit's Petition for Rehearing in these cases:

> * * * Capital gains simply do not form part of the cost of service and that is the reason ratepayers need not pay for the use of assets based upon their value. Accordingly, since the capital gains have only to do with the fact of ownership, the utility is entitled to the benefit thereof.[21]

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[21] Brief in the Court of Appeals for Potomac Electric Power Co. as Amicus Curiae in Support of Petition for Rehearing and Suggestion for Rehearing En Banc at 6 (Nos. 21,865, 23,720, 24,398 and 24,428).

Growth in value is an essential element of the land itself, which belongs to the utility's investors and which cannot be taken without just compensation, even within the framework of ratemaking.

Moreover, to strip the investors of the capital gains on land in these circumstances is confiscatory. *Smyth* v. *Ames,* 169 U.S. 466 (1898), firmly established the principle that utility investors are entitled, as a matter of due process, to a reasonable opportunity to earn from ratepayers a reasonable return on their investment.[22] As discussed above, *Hope Natural Gas* altered that principle only to the extent of establishing that the original cost of the utility's assets may form the base against which a reasonable return is determined. It did not alter the fundamental constitutional principle of ratemaking that users must pay the cost of service. However, the Court of Appeals would overturn seventy-five years of constitutional law with the novel theory that ratepayers do not have to pay the cost of service to the extent that a utility's assets have grown in value. Indeed, under the court's view, ratepayers would avoid *any* charge for service where land values had increased sufficiently to offset their entire obligation to pay.

The Court of Appeals has remanded to the Commission with instructions to calculate the total in-service appreciation on the land that Transit sold or transferred to non-operating status, which amount *shall,* according to the court, represent the amount of restitution (App. 85a). The court has done so without regard to whether a rate originally calculated on that basis in

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[22] *See also Board of Comm'rs* v. *New York Tel. Co., supra,* 271 U.S. at 32; *Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Service Comm'n,* 262 U.S. 276, 289 *et seq.* (1923) (Brandeis Holmes, J.J., concurring).

1968 and 1970 would have been confiscatory. Indeed, in granting Transit its proposed increase in 1968, the Commission found that Transit's existing rates were so low as to be "unjust and unreasonable" because they would "not produce sufficient revenues to enable the carrier to meet its operating expenses and earn a reasonable return."[23] Now the court holds, in effect, that the Commission should have *decreased* the fares it set in response to that finding by an amount equal to the "paper gains" in land values, with no room for the Commission to determine whether rates set under these criteria would have permitted Transit even to meet its operating expenses, let alone provide a reasonable return for investors. The Due Process Clause guarantees a utility the right to rates that will not compel it to operate at a loss;[24] indeed, a utility is entitled to the opportunity to earn sufficient profit to attract investors.[25] The court's opinion deprives utilities of that opportunity.

Finally, the court's opinion denies Transit due process because it would permit past profits to sustain confiscatory rates for the future, a proposition that, until now, has been soundly rejected as a violation of due process guarantees.[26]

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[23] *D. C. Transit System, Inc., supra,* 72 P.U.R.3d at 159.

[24] Nichols, *Ruling Principles of Utility Regulation: Rate of Return* 22-25 (1955).

[25] *Id.* at 27-30.

[26] *Newton* v. *Consolidated Gas Co. of New York,* 258 U.S. 165, 175 (1922); *Board of Comm'rs* v. *New York Tel. Co., supra,* 271 U.S. at 31; *Los Angeles Gas & Electric Corp.* v. *Railroad Comm'n of California,* 289 U.S. 287, 313 (1933); *Pacific Tel. & Tel. Co.* v. *California Public Utility Comm'n,* 62 Cal.2d 634, 401 P.2d 353, 44 Cal. Rptr. 1 (1965); 1 Priest, *Principles of Public Utility Regulation* 75 (1969).

In the court's own view, Transit "earned" income at the time it transferred land to non-operating status. The amount of that income was the appreciation over cost at the time of the transfer. Some of these transfers occurred as early as 1958 (App. 90a-93a). Most, if not all, occurred prior to both rate orders under review. Yet the court has now said that in setting Transit's future rates in 1968 and again in 1970, the Commission should have credited as an offset to such future rates this income that Transit "earned" in prior years. The court's prescription consists of using past profits to support future rates, and yet there are no means provided, under the court's narrow remand instructions and its own view of the case, to determine whether such past profits are sustaining what otherwise would be confiscatory rates. To permit this holding to stand would be to emasculate due process protections to which regulated utilities have been historically and necessarily entitled.

II. By Retroactively Reversing Firmly Settled Law on the Proper Treatment of Land Appreciation, the Court Has Denied Transit the Procedural Guarantees of the Due Process Clause.

Retroactive changes in settled law can result in the kind of gross unfairness that violates procedural due process guaranteed by the Fifth Amendment.[27] This

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[27] *United States* v. *Macdaniel*, 32 U.S. (7 Pet.) 1, 14, 15 (1833); *Gelpcke* v. *City of Dubuque*, 68 U.S. (1 Wall.) 519 (1864); *Douglass* v. *County of Pike*, 101 U.S. 968 (1880); *Green County* v. *Conness*, 109 U.S. 104 (1883); *Edward Hines Yellow Pine Trustees* v. *Martin*, 268 U.S. 458 (1925). Stimpson, *Retroactive Application of Law—A Problem of Constitutional Law*, 38 MICH. L.R. 30 (1938); 1 Davis, *Administrative Law Treatise* §§ 5.08-5.09. The above authorities deal primarily with retroactivity in judicial

is particularly true where the party asserting the denial has changed his position in reliance upon the existing law. The principle that capital gains on a utility's land belong to the investors has been firmly established not only in the regulation of Transit, but as a principle universally applied in the utility industry.

The Commission's predecessor, the PUC, first promulgated a regulation on the proper treatment of land appreciation in 1946.[28] That regulation stated that when land is transferred "below the line," no income is realized. The property merely is transferred, at book value, to a non-operating property account on the company's books. When land is sold, any gain is profit, *i.e.*, a credit to earned surplus.

The "rules, regulations, orders" and "decisions" of the PUC survived the Commission's succession unless and until changed.[29] The PUC and the Commission have consistently applied this regulation to Transit. The PUC first explicitly faced the issue of allocating

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decision-making. In addition, the more numerous cases and authorities dealing with retroactive application of legislative enactments are also apposite since ratemaking is a legislative act (*see* n. 17, *supra*. *See, e.g.*, Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L.R. 692 (1960).

[28] *Capital Transit Co.* (Order No. 3087) (PUC Sept. 23, 1946) (unreported). That rule was specifically discussed by the Commission in *D. C. Transit System, Inc.* (Order No. 981), 81 P.U.C.3d 113, 126-127 (WMATC 1969). The court's contention that there apparently was no operative accounting rule on the issue (App. 66a) is, as Judge MacKinnon pointed out in his dissent (App. 123a), "selective blindness."

[29] Compact, *supra*, at tit. II, art. XII, § 21.

capital gains on land between investors and farepayers in a 1959 rate proceeding.[30] It stated:

> * * * The staff and the company are in agreement that under public utility accounting, the difference between the original cost of the land and the selling price is recognized as profit. The net profit * * * on the sale of the land * * * is, therefore, a proper credit to earned surplus. [*Id.* at 409.]

This aspect of the PUC's holding was not appealed.

The issue was again raised, before the Commission, in 1963.[31] The Commission stated that:

> * * * While the ratepayers may have a claim to depreciable property, at least to the extent of the depreciation reserves, no such claim can be directed to land. [*Id.* at 399.]

Again, this aspect of the Commission's determination was not appealed.

The three authorities to the contrary cited by the panel majority in the instant cases do not, as Judge MacKinnon pointed out in dissent (App. 100a), support its conclusion. Two of them stand for the proposition that the benefit of capital gain accompanies the risk of capital loss.[32] Therefore, where a utility commission's accounting procedures provide that rate-

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[30] *D. C. Transit System, Inc.* (Order No. 4577), 30 P.U.R.3d 405 (PUC 1959).

[31] *D. C. Transit System, Inc.* (Order No. 245), 48 P.U.R.3d 385 (WMATC 1963).

[32] *New York Water Service Corp.*, 7 P.U.R.3d 32 (N.Y. Public Service Comm'n 1955), *aff'd, New York Water Service Corp.* v. *Public Service Comm'n*, 12 App. Div.2d 122, 208 N.Y.S.2d 857 (1960); *Columbia Gas Co.* v. *Public Utility Comm'n*, 292 U.S. 398, 410-411 (1934) (distinguished by Judge MacKinnon, App. 103a, 104a n.25).

payers must bear any losses on land—a practice manifestly not employed by the Commission here—the utility commission is not acting unreasonably in crediting gains on land to the ratepayers. The third has been overruled on the precise issue here involved.[33] That is the extent of the court's precedents. There are no more. As Judge MacKinnon pointed out, the dearth of decided cases is "more indicative of the fact that no one previously has ever imagined of or argued for such a novel approach with respect to non-depreciable properties" (App. 100a).

The position consistently taken by the Commission is in all relevant respects the same as that authorized by the Uniform Systems of Accounts used by the District of Columbia Public Service Commission for District gas and electric utilities;[34] by the Federal Power Commission for gas and electric companies;[35] by the Interstate Commerce Commission for railroads, electric railways, and passenger motor carriers;[36] and it is the same as that recommended by the National Association of Regulatory Utility Commissioners for state commissions that regulate gas, water and electric utilities.[37]

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[33] *City of Lexington* v. *Lexington Water Co.*, 458 S.W.2d 778 (Ky. Ct. App. 1970), *rev'g, Lexington Water Co.*, 72 P.U.R.3d 253 (Ky. Public Service Comm'n 1968).

[34] The PSC employs the Uniform System of Accounts for Natural Gas Companies prescribed by the FPC. (*See* n.35, *infra*. *See e.g.*, Order No. 5455 (PSC Jan. 29, 1971) (unreported).

[35] Uniform System of Accounts Prescribed for Natural Gas Companies, F.P.C. Transmittal Sheet No. 1, July 29, 1970.

[36] 49 C.F.R. §§ 1201.2-8(c), 1202.06-7, 1206.2-21(d).

[37] See the following publications by the National Association of Regulatory Utility Commissioners: *Uniform System of Accounts for Class A and B Gas Utilities* (1972); *Uniform System of Ac-*

In formulating its financial planning, the Company relied upon these consistently applied and generally accepted accounting principles that were applicable at the time of the transfers. It made decisions about whether or not to transfer the properties here involved—and thereby assume the cost of their maintenance and taxes—based upon the settled accounting principles in effect at that time. It decided whether to retain these properties or sell them, whether to leave them vacant or rent them, and the extent to which debts should be incurred upon them as security, all based upon a set of established principles in effect at that time. It made decisions about its ability to expand operations and operating expenses—for example, in wage negotiations with its unions—based upon the fact that its earned surplus included gains on land it already had sold and would include gains on land it could sell. And investors and creditors made decisions based upon the same assumptions. Transit, its parent, its parent's more than 7,000 shareholders, and Transit's creditors were all entitled to rely upon these principles which had been approved by numerous final rate orders of the Commission and had never been questioned by the Court of Appeals.

Although the court referred to the allegedly "unique" circumstances of this case (App. 2a), nothing in its opinion identified any reason to distinguish this situation from those faced by other regulated utilities. To the contrary, as has been noted, the accounting practices overturned by the court are applied to all

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counts for Class A and B Water Utilities (1957); *Uniform System of Accounts for Class C Water Utilities* (1972); *Uniform System of Accounts for Class D Water Utilities* (1957); *Uniform System of Accounts for Class A and B Electric Utilities* (1972); *Uniform System of Accounts for Class C and D Electric Utilities* (1973).

utilities in the District of Columbia and employed by the federal agencies which have regulatory authority for public utilities throughout the nation. Those agencies also fall within the jurisdiction of the Court of Appeals for the District of Columbia Circuit. And in striking the equity balance between investors and consumers, the panel majority, as Judge MacKinnon pointed out (App. 121a), considered a number of factors which are equally applicable to all utilities.

The uncertainty resulting from the decision below directly and immediately translates into higher costs for credit and greater difficulty in attracting investors for all regulated utilities. As the American Gas Association stated in its Amicus Curiae brief in support of the Petition for Rehearing in these cases:

> * * * A rule which leaves matters of utility regulation to *ex post facto* determination on a case-by-case basis will have exactly the same effect on utility financing and capital structure as the most adverse decision which could be made in any case. Investors looking to the acquisition of utility common stock, whether of existing issues or in new financings, would realistically have to assume the most adverse decision before making an investment * * *.[38]

The Court of Appeals has rendered a constitutionally unsound decision at a distinctly unpropitious moment. Although it is obviously impossible to project its impact with certainty, it is clear that it could deal a critical blow to this nation's capacity to respond to a pressing energy crisis.

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[38] *Amicus curiae* brief for the American Gas Association, *supra*, at 2.

III. By Discarding Established Commission Practices Which Were Eminently Reasonable, the Court Has Exceeded Its Proper Scope of Review.

This Court has repeatedly stated that, when administrative accounting practices are being reviewed, the role of a court is severely limited. The "basic principle" of such judicial review was stated by this Court in *American Tel. & Tel. Co.* v. *United States,* 299 U.S. 232 (1936). In reviewing an order of the Federal Communications Commission prescribing its Uniform System of Accounts, the Court said:

> This court is not at liberty to substitute its own discretion for that of administrative officers who have kept within the bounds of their administrative powers. To show that these have been exceeded in the field of action here involved, it is not enough that the prescribed system of accounts shall appear to be unwise or burdensome or inferior to another. Error or unwisdom is not equivalent to abuse. What has been ordered must appear to be "so entirely at odds with fundamental principles of correct accounting" (*Kansas City Southern Ry. Co.* v. *United States,* 231 U.S. 423, 444 [1913]) as to be the expression of a whim rather than an exercise of judgment. * * * [*Id.* at 236-237].[39]

Although the majority in the instant cases gave lip service to a "rational basis" standard of review, in fact, as other language in the majority and dissenting opinions clearly shows, the majority merely substituted its own judgment of the preferable account-

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[39] *See also Kansas City Southern Ry. Co.* v. *United States, supra; Dobson* v. *Comm'r,* 320 U.S. 489, 502 (1943); *Mississippi Valley Barge Line Co.* v. *United States,* 292 U.S. 282, 286-287 (1934).

ing procedures and of the equities for that of the Commission.[40]

The Commission, like its predecessor, the PUC, is charged with broad authority and discretion in prescribing "rules and regulations" controlling the accounting procedures of utilities under its jurisdiction.[41] That the Commission's rule on land appreciation, discussed above, is "reasonable" is abundantly clear. As has been pointed out, it can hardly be "entirely at odds with fundamental principles of correct accounting" since it is the identical rule that is applied by virtually every, if not in fact all, utility regulatory agencies in the country.[42] Conversely, the opposite rule adopted by the court is, as has also been pointed out, wholly unprecedented.

Indeed, the Commission's consistently applied accounting practice is eminently "reasonable" even when measured against the court's own rationale for overturning it. Perceiving no constitutional compulsion to leave growth to the owners of property, the court proceeded to weigh the equities. In so doing, it articulated two controlling "doctrinal considerations": (a) that he who bore the *risk of capital loss* should be entitled to any capital gains, and (b) that he who bore the *financial burden* of this property should also reap the benefits therefrom (App. 39a-50a).

As Judge MacKinnon pointed out (App. 97a-99a), the panel majority confused the effect of these princi-

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[40] For example, the majority concluded that the Commission "erred" (App. 2a, was "in error" (App. 6a), was "erroneous" (App. 82a), and that, in the court's view of the equities, the scales were "tipped" in favor of the ratepayers (App. 72a). *See also* the dissent at App. 96a.

[41] Compact, *supra* at tit. II, Art. XII, §§ 6, 10, 15.

[42] See pp. 18-19, *supra*.

ples on *non-depreciable* land with their effect on *depreciable* property. Thus, while it is true that farepayers must bear the *risk of loss* on depreciable property,[43] the Commission has made it clear that *investors* bear the risk of loss on land.[44] And although farepayers do carry the *financial burden* of depreciable property, to the extent that depreciation is an expense reimbursed by fares, land is not depreciable.[45] The investors bear the cost. They are not reimbursed. Accordingly, the court's own determinative principles would indicate that the investors should be entitled to the gain.

The court grossly overstepped its legitimate range of review in striking down a reasonable Commission rule, proceeding to determine for itself the relevant equities, and actually balancing those equities in the particular situation at hand, all without regard to the Commission.

CONCLUSION

For the reasons stated above, we respectfully pray that the Court grant the writ and reverse the opinions and judgments of the Court of Appeals in the instant cases.

Respectfully submitted,

E. BARRETT PRETTYMAN, JR.
SAMUEL R. BERGER
815 Connecticut Avenue, N.W.
Washington, D.C. 20006
Attorneys for Petitioner

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[43] For example, if a depreciable asset becomes suddenly obsolescent and is retired, farepayers are obligated to make up for the under-depreciation by charges to the depreciation reserve.

[44] *D.C. Transit System, Inc., supra*, 48 P.U.R.3d. at 400.

[45] *Id.* at 399-400.

APPENDIX A

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 21,865

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, *et al.*, PETITIONERS

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, RESPONDENT

D. C. TRANSIT SYSTEM, INC., INTERVENOR

Petition for Review of an Order of the Washington Metropolitan Area Transit Commission

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Decided June 28, 1973

Landon G. Dowdey, with whom *S. David Levy, Neil J. Cohen* and *William A. Grant* were on the brief, for petitioners.

Douglas N. Schneider, Jr., General Counsel, Washington Metropolitan Area Transit Commission, for respondent.

Harvey M. Spear for intervenor.

Before ROBINSON and MACKINNON, *Circuit Judges,* and DAVIS,* *Judge,* United States Court of Claims.

Opinion for the Court filed by *Circuit Judge* ROBINSON.
Opinion concurring in part and dissenting in part filed by *Circuit Judge* MACKINNON, at p. 93.

ROBINSON, *Circuit Judge*: This petition subjects to review Order No. 773 of the Washington Metropolitan Area Transit Commission [1] in an aspect untouched by today's *Powell* decision.[2] Petitioners assert, as their major contention, that the Commission should have taken into account, in the fare-setting process leading to that order, the amount by which properties which Transit had transferred from operating to nonoperating status had appreciated in value while in service. We conclude, in the circumstances peculiar to Transit as a public utility, that the Commission erred in refusing to treat the excess of market value over book value of the properties when transferred as an offset to higher fares.[3] To that extent we hold Order No. 773 invalid and direct the remedial steps to be taken. In the other respect in which the order is complained of, we affirm the Commission.[4]

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* Sitting by designation pursuant to 28 U.S.C. § 293(a) (1970).

[1] *D.C. Transit Sys., Inc.* (Order No. 773), 72 P.U.R.3d 113 (WMATC 1968).

[2] *Powell* v. *Washington Metropolitan Area Transit Comm'n,* No. 21,750 (D.C. Cir. June 28, 1973).

[3] See also *Bebchick* v. *Washington Metropolitan Area Transit Comm'n,* No. 23,720 (D.C. Cir. June 28, 1973); *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n,* No. 24,398 (D.C. Cir. June 28, 1973).

[4] See note 16, *infra.*

I

BACKGROUND

The evolution of Order No. 773 is summarized in our *Powell* opinion.[5] We need add only the events of record which bear particularly on the transferred assets.[6] All are parcels of real estate which in times past were employed by Transit in mass transportation operations, but which, after later losing their usefulness for that purpose, were withdrawn from service. These withdrawals are reflected by entries on Transit's books recording the removals—in utility jargon, from "above the line" to "below the line"—and denoting Transit's continuing interest in the properties as investments. In some instances, Transit retains direct ownership; in others, Transit has conveyed to a wholly-owned subsidiary, and in still others it has made an outright sale. It appears without controversy that the market value of the unsold properties at the time of transfer below the line has invariably exceeded their value as tabulated on Transit's books.[7]

During the course of the proceeding before the Com-

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[5] *Powell* v. *Washington Metropolitan Area Transit Comm'n, supra* note 2, at 2-5.

[6] Many important facts pertaining to these properties are in dispute. We need not, for present purposes, undertake to resolve the disputes, and in any event we are not in position to do so. Simply as a point of reference, we reproduce, as an appendix to this opinion, the representation made in the Commission's brief, a1 to a3, in *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 3. Our disposition of this case includes prominently a direction to the Commission to identify the properties and the material facts as to each. See Part V, *infra*, following note 387.

[7] Witnesses before the Commission had so testified, and Transit's counsel conceded as much.

mission, petitioners endeavored to probe into Transit's below-the-line real estate, Transit's interrelationships with its subsidiaries, and the market value of withdrawn realty held by either. Transit resisted those efforts, maintaining that the properties belonged exclusively to its investors,[8] and that information concerning them was irrelevant to the fare investigation in which the Commission was engaged.[9] The Commission, subscribing to Transit's basic premise, ruled that petitioners' inquiries had but limited pertinence to the proceeding.[10] It directed that some of the sought-after information be made available to petitioners, but

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[8] In speaking of Transit's "investors" we employ the language of ratemaking litigation. We are fully aware of the fact that Transit is a wholly-owned subsidiary of another corporation.

[9] Transit's counsel argued

> that it is virtually axiomatic that non-depreciable property upon which no return is allowed, upon which no depreciation is allowable, and non-operating property upon which no return is allowed in a rate base proceeding, and upon which no depreciation is allowed, are both matters which are not properly within the province of a rate proceeding.

Counsel had earlier assumed a broader position:

> [T]he appraised market value of non-operating property does not belong in a rate proceeding. It is not part of what this Commission can consider as far as the rate of return is concerned, and it is not part of what affects the rate structure which any member of the public pays. If there is a loss on the sale of that real estate the stockholders bear it, and if there is a profit on the sale it goes to the stockholders of the company. . . . [N]one of these items requested here today as to non-operating properties are relevant in this proceeding . . . and the company will decline to furnish that information at this time because we don't think it is relevant.

[10] See note 11, *infra*.

refused to require disclosure of any market-value data on the properties.[11]

Not surprisingly, then, Order No. 773 reflects no consideration whatever by the Commission of rises in the value of the transferred assets during the course of structuring the increased fares which that order awarded. Petitioners filed a timely petition for reconsideration[12] containing, *inter alia*, what may fairly be characterized as a request that the Commission devise ways and means of giving Tran-

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[11] The Commission's chairman declared "that the proceeds from non-operating property belong to the stockholders of the company and not to the rate-payer," but felt that the information requested was not completely irrelevant. Since some of the information had been supplied the Commission's staff by Transit, the chairman instructed the staff to make certain of it available to petitioners' counsel. The chairman ruled, however, that neither the staff nor Transit would be required to disclose information regarding the current market value of the properties, and, addressing petitioners' counsel, that "[i]f that is information you think is pertinent or you think should be in the record it will be up to you . . . to adduce that evidence." Petitioners, later undertaking something of a showing as to market value of the properties, introduced the valuation of the properties for tax purposes and testimony assuming that the assessments approximated 55% of true market value.

[12] See Washington Metropolitan Area Transit Regulation Compact, tit. II, art. XII, § 16 (Transit Regulation Compact), incorporated into Pub.L. No. 86-794, 74 Stat. 1031 (1960), with amendments, appearing as a part of Pub.L. No. 87-767, 76 Stat. 764 (1962), set forth following D.C. Code § 1-1410a (1967). Title II of the Transit Regulation Compact is the Washington Metropolitan Area Transit Authority Compact (Transit Authority Compact), which is incorporated into Pub.L. No. 89-774, 80 Stat. 1324 (1966), and is set forth following D.C. Code § 1-1431 (1967). In this opinion, we refer to the Transit Regulation Compact and the Transit Authority Compact together as the "Compact."

sit's farepayers appropriate credit for the appreciation in value of the properties while in service. By Order No. 781, the Commission denied the petition,[13] and by Order No. 781a stated its reasons for doing so.[14] The Commission's statement, like Order No. 773 itself, is devoid of anything which we can identify as a response to petitioners' entreaty. And so it is that the theory underlying their plea is presented here,[15] now to support the charge that the Commission was grievously in error.[16]

We have painstakingly examined this serious charge in all of its many ramifications, and in this opinion we set

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[13] *D.C. Transit Sys., Inc.* (Order No. 781) (WMATC Feb. 26, 1968) (unreported).

[14] *D.C. Transit Sys., Inc.* (Order No. 781a), 74 P.U.R.3d 178 (WMATC 1968).

[15] See Compact, *supra* note 12, tit. II, art. XII, § 17.

[16] Petitioners also allude to several other complaints they have against Order No. 773, and ask for remand of the case to the Commission for reconsideration in light of *Williams* v. *Washington Metropolitan Area Transit Comm'n*, 134 U.S. App.D.C. 342, 415 F.2d 922 (*en banc* 1968), *cert. denied*, 393 U.S. 1081 (1969), and *Payne* v. *Washington Metropolitan Area Transit Comm'n*, 134 U.S.App.D.C. 321, 415 F.2d 901 (1968). In their brief, however, petitioners offer no argument whatever in support of these points. We accordingly decline to consider them. Fed.R.App.P. 20, 28(a)(4); D.C. Cir. R. 4(b)(5); *Cratty* v. *United States*, 82 U.S.App.D.C. 236, 243, 163 F.2d 844, 851 (1947); *Abrams* v. *American Sec. & Trust Co.*, 72 App.D.C. 79, 80, 111 F.2d 520, 521, 129 A.L.R. 368 (1940); *S. S. Kresge Co.* v. *Kenney*, 66 App.D.C. 274, 275 n.1, 86 F.2d 651, 652 n.1 (1936); *Smith* v. *Pickford*, 66 App.D.C. 206, 209 n.6, 85 F.2d 705, 708 n.6 (1936); *Schwartzman* v. *Lloyd*, 65 App.D.C. 216, 218, 82 F.2d 822, 824 (1936); *Helvering* v. *Helmholz*, 64 App.D.C. 114, 117, 75 F.2d 245, 248 (1934), *aff'd*, 296 U.S. 93 (1935); *Ginder* v. *Giuffrida*, 61 App.D.C. 338, 340, 62 F.2d 877, 879 (1932); *Wardman-Justice Motors* v. *Petrie*, 59 App.D.C. 262, 267, 39 F.2d 512, 517, 69 A.L.R. 648 (1930).

forth the results of our investigation. We begin in Part II with an exploration into the adjudicative history, administrative and judicial, of allocations of capital gains on operating utility assets. After that, in Part III, we scrutinize the interest of investors in value-appreciations on such assets, with reference to treatments of that interest in rate- and depreciation-base formulations and, more particularly, in Transit's ratemaking litigation. Next, in Part IV, we identify the doctrinal considerations guiding allocations of capital gains on in-service utility property and apply them to this case. Then concluding that Order No. 773 is invalid and must be set aside, we specify in Part V the basis for and mechanics of remediation.

II

ADJUDICATIVE HISTORY OF ALLOCATION OF CAPITAL GAINS ON OPERATING UTILITY ASSETS

Seldom have regulatory agencies or courts been called upon to allocate, as between investors and consumers, gains on utility assets while in operating status.[17] Nonetheless, for the assistance and indispensable background they may afford to resolution of the controversy at hand, we must pause to examine this group of cases. In the realization that problems of allocation may well differ according to whether the asset is depreciable [18] or nonde-

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[17] No issue as to allocation of capital gains and losses once an asset is transferred below the line is tendered to us on this review.

[18] We use the word "depreciation," as it is commonly employed in District ratemaking, to refer not merely to physical wear and tear but also to other types of diminution of serviceability. *E.g., D.C. Transit Sys., Inc.* (Order No. 245), 48 P.U.R.3d 385, 397 (WMATC 1963), *remanded sub nom.*

preciable, we look first to the decisions treating allocation issues in relation to depreciable properties.

A. *Depreciable Assets*
—Out-of-District Cases

Outside the District of Columbia, we find relatively little authority precisely in point. In 1959, the question was presented to the Appellate Division of the New Jersey Superior Court [19] after a utility providing water service made a profitable sale of a portion of its distribution system, consisting of cast-iron mains and fire hydrants.[20] In subsequent rate proceedings, the New Jersey Board of Public Utility Commissioners deducted the profit from the utility's earned surplus and credited it to its depreciation reserve, in conformity with the board-adopted uniform system of accounts for water companies. From 1931, when the sale was made, to 1958, when the rate case was instituted, the utility had not complained of this treatment. Ascribing controlling weight to the commissioners' long

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D.C. Transit Sys., Inc. v. *Washington Metropolitan Area Transit Comm'n*, 121 U.S.App.D.C. 375, 350 F.2d 753 (*en banc* 1965), *on remand sub nom. D.C. Transit Sys., Inc.* (Order No. 563), 63 P.U.R.3d 32 (WMATC 1966), *rev'd sub nom. Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, where the Commission said:

> Depreciation is the exhaustion of the service life of the property in use. The accrued depreciation in the property at a given time is the sum total of the exhausted service life of the various units of the property at that time. This exhaustion of service life is the combined result of the working of three factors, namely: (1) inadequacy, (2) obsolescence, and (3) physical deterioration.

[19] *In re Revision in Rates Filed by Plainfield-Union Water Co.*, 57 N.J.Super. 158, 154 A.2d 201 (1959).

[20] 154 A.2d at 205, 211.

standing construction of their own regulation—the accounting system prescribed—the court found no error in the challenged adjustment.[21]

In the same year, a similar question arose in a rate proceeding before the Minnesota Railroad and Warehouse Commission.[22] During its historical test period, a transit company sold obsolete buses and treated the proceeds as nonoperating income. This was held to be improper.[23] "The Uniform System of Accounts prescribed by this Commission," said the agency, "requires that such salvage[24] 'shall be credited to the depreciation reserve account.'"[25] In its words, the agency accordingly "added this income from sale of obsolete buses to operating income in determining actual operating results. . . ."[26] "[A]ny further income from sale of obsolete buses or equipment," the agency added, "will be treated . . . as a reduction in depreciation expense and, thus, as an increase in operating income."[27]

A few years later, the Wyoming Public Service Commission faced essentially the same problem in a variant context.[28] A utility engaged in selling natural gas pur-

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[21] 154 A.2d at 211.

[22] *Minneapolis St. Ry. Co.*, 31 P.U.R.3d 141 (Minn. R.R. and Warehouse Comm'n 1959).

[23] *Id.* at 152.

[24] The agency's reference to salvage, viewed in context, is seemingly to the entire proceeds of sale, and not simply to the amount of future recoupment originally estimated for depreciation-computation purposes.

[25] 31 P.U.R.3d at 152.

[26] *Id.*

[27] *Id.*

[28] *Wyoming Gas Co.*, 40 P.U.R.3d 509 (1961) (Wyo. Pub. Serv. Comm'n 1961).

chased mineral interests in lands, including a gas-producing well. The utility thus became entitled to a depletion allowance on the purchased assets.[29] After taking some gas from the purchased properties for its southern division customers, the utility sold them at a profit. Regulatory approval of the sale had been accompanied by a direction to treat the profit as utility income. In a later rate proceeding, the Commission reiterated its position that the profit "must be treated as nonoperating utility income."[30] The theory underlying the order approving the sale, the Commission said, was that "the profit to be made by the company upon the sale thereof should be used to reduce its . . . natural gas rates, rather than increase them."[31] "As we view the transaction," the Commission explained, "the company will simply make the substantial profit from the sale of utility properties dedicated to its southern division operations, which, in our opinion, should inure to the benefit of the ratepayers in that division."[32]

Such are the decisions outside this jurisdiction. In each, the entire gain from disposition of depreciable assets was passed on to the utility's consumers, to the exclusion of its investors. While it is true that two of the decisions were influenced by agency-adopted accounting practices, it must be remembered that such practices are but reflections in accounting technique of what is generally considered wholesome in substantive principle. And the principle to be gleaned, both from the practices and the decisions themselves, is that consumers have the superior claim on capital gains achieved when depreciable utility properties are removed from service. We do not suggest that so small a

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[29] See Part V(A), *infra*, at note 222.

[30] 40 P.U.R.3d at 513.

[31] *Id.*

[32] *Id.*

number of cases establish a rule of general and controlling applicability in the ratemaking field. But it can hardly be denied that these decisions are precedents of value in similar litigation.

—District Cases

Within, much as without, the District of Columbia the problems of allocating value-appreciation of depreciable inservice utility property have but infrequently arisen before either regulatory agencies or courts. And the litigation locally, such as it has been, has invariably involved Transit and, by the same token, the peculiarities inherent in its situation. That is to say not only that the reasoning followed elsewhere obtains as to Transit, but also that additional reasons leading to similar results flow from Transit's uniqueness, in comparison with other utilities, with respect to properties transferred below the line. Not surprisingly, then, the claim of Transit's farepayers on capital gains accruing to such properties while above the line has achieved considerable fruition.

The leading case, and one which merits careful analysis, is *D.C. Transit System, Inc.* (Order No. 4577).[33] There the Commission's predecessor, the District of Columbia Public Utilities Commission (PUC),[34] addressed the question of allocating the profits on a sale of Transit's Fourth Street Shops and Southern Carhouse to the District of Columbia Redevelopment Land Agency. Of the total sale price of $3,320,000, Transit proposed to credit all of the net profit of $2,181,363.08 to earned surplus, and thereby to pass it on to its investors.[35] This, PUC held, it could not be permitted to do.

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[33] 30 P.U.R.3d 405 (D.C. Pub. Utils. Comm'n 1959).

[34] Now the District of Columbia Public Service Commission.

[35] 30 P.U.R.3d at 406.

As PUC determined, $1,039,657.72 of the sale price was attributable to land,[36] $1,915,034.81 to depreciable improvements on the land,[37] and the remainder to items not of present concern.[38] PUC noted that strict adherence to the uniform system of accounts employed by it would require that the total amount received on disposition of depreciable assets—here $1,915,034.81—be credited to the depreciation reserve as salvage.[39] Since to have done that would, by PUC's calculations, have built the reserve to a point greatly in excess of the sum needed to retire all unrecovered original cost of the improvements,[40] PUC felt that a departure from normal accounting procedures was warranted.[41]

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[36] *Id.* at 407, 409. So, after subtracting $89,089.17, representing the original cost of the land, a net profit of $950,568.55 was realized on this aspect of the sale. *Id.* at 407, 409, 411.

[37] *Id.* at 409. Original cost of this portion of the sold property was determined to be $1,077,824.06. *Id.* The depreciation reserve on the improvements was then $613,661.28, leaving $464,162.78 as the unrecovered original cost. *Id.* at 411. Thus net profit on the sale of the depreciable portion of the property was $1,450,872.03—the sale price of $1,915,034.81 less unrecovered original cost of $464,162.78.

[38] See *id.* at 407-09. A part of the remainder was $36,550.92, net, representing so much of the sale price as was related to certain equipment and machinery. Because of uncertainty as to the items of equipment and machinery included in the sale, PUC placed that amount in a suspense account pending ascertainment, "at which time determination will be made as to what portion thereof should be credited to the depreciation reserve and what portion, if any, should be credited to earned surplus." *Id.* at 409.

[39] *Id.* at 410.

[40] The unrecovered portion of original cost was $464,162.78, that is, original cost of $1,077,824.06 less depreciation reserve of $613,661.28. See note 37, *supra*.

[41] 30 P.U.R.3d at 410.

In regard to the extent of the departure, PUC noted that Transit's operating franchise demanded of it a seven-year program of gradual conversion from a streetcar-bus to an all-bus operation,[42] and PUC was "unable to disassociate the instant transaction from the imminent retirement of all rail property under the mandate contained in the Franchise."[43] Nor could PUC "ignore the probability that full provision for depreciation will not have been provided when the rail facilities are abandoned and retired by reason of conversion."[44] Observing that Transit had consistently asserted, and PUC's staff had indicated agreement, that any retirement loss in this connection was recoverable by charges against the farepayers,[45] PUC emphasized that "if the customers are to be required to bear the burden of extraordinary retirement losses incident to the whole conversion program, it appears equitable that they should share, at least to some extent, in extraordinary retirement gains of the nature here under consideration."[46]

PUC concluded, then, that of the total net profit of $1,450,872.03 realized on the sale of the improvements,[47]

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[42] Transit had purchased the assets of Capital Transit Company, its predecessor, which for many years had operated a system of transportation by streetcars and buses in the Washington metropolitan area. The obvious purpose of the franchise provision mentioned in text was to eliminate the streetcars. This matter is discussed more fully in Part IV(B), *infra*.

[43] 30 P.U.R.3d at 412.

[44] *Id.*

[45] *Id.* That such losses did fall on Transit's farepayers subsequently became the fact. See Part IV(B), *infra*, at notes 243-46.

[46] 30 P.U.R.3d at 412.

[47] See note 37, *supra*.

$613,661.28 should inure to Transit's consumers and $837,-210.75 to its investors.[48] "This approach," it said, "takes into consideration the right of the company to recover from its customers through depreciation the loss of service value over the life of the property as measured by the original cost of the property less net salvage realized upon retirement."[49] That treatment, in PUC's view, "provides an equitable solution to a difficult problem maintaining, as far as possible, what seems to be fair balance between the interests of the public and those of the company's investors."[50]

PUC's allocation of the profit on the improvements on the Fourth Street Shops and Southern Carhouse subsequently came under direct judicial review at Transit's instance, and we held that PUC's treatment was not arbitrary or unreasonable.[51] That allocation also entered into this court's consideration of another problem several years later. In *D.C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission*,[52] an expense allowance to Transit for unrecovered costs of abandoned rail facilities was contested on grounds which included reference to that sale. The argument was that the sale was occasioned by the conversion program required by Transit's franchise,[53] and that for that reason the profits made on the sale should be regarded as recoupment of obsolescence.[54] In rejecting the

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[48] 30 P.U.R.3d at 411.

[49] *Id.*

[50] *Id.* at 412.

[51] *D.C. Transit Sys., Inc.* v. *Public Utils Comm'n*, 110 U.S. App.D.C. 241, 292 F.2d 734 (1961). See also Part III(B), *infra*, at notes 89-99.

[52] *Supra* note 18.

[53] See note 42, *supra*, and accompanying text.

[54] 121 U.S.App.D.C. at 397, 350 F.2d at 775. The same argument was made with reference to a capital gain achieved

argument, we noted that

> PUC did not omit to give the riding public some considerable share in the benefits of this sale. . . . [T]he profit on the depreciable property which went into surplus was $837,000. At the time of the sale, Transit carried this property on its books at an historical cost of $1,077,824, with an accrued depreciation reserve of $613,661. Thus only $464,163 was required from the proceeds of the sale to effect complete liquidation of this investment. The PUC, however, ordered a total of $1,077,824 be credited to the depreciation reserve, representing not only the $464,163 but an additional amount of $613,661 exactly duplicating the reserve already accrued. It was this action that we think was explained by the PUC's comment that equitable consideration suggested the riders should share in the profits from the sale. Under all these circumstances, therefore, we do not interefer with the Commission's discretion in deciding not to off-set the profits from the Fourth Street Shop sale against the [expense allowance for unrecouped investment in abandoned rail facilities].[55]

That, as PUC held in Order No. 4577,[56] Transit's farepayers have a legitimate interest in capital gains on operating depreciable assets has never been doubted by its successor, the respondent Commission. In *D.C. Transit System, Inc.* (Order No. 245),[57] the Commission recognized that "ratepayers may have a claim to depreciable property at least to the extent of the depreciation reserves."[58] It added "that 'gains' may be experienced on

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on the depreciable portion of Transit's Georgia and Eastern Terminal. We discuss the disposition of that facet of the argument in Part IV(B), *infra*, at notes 292-300.

[55] *Id.* (footnote omitted).

[56] See text *supra* at notes 34-50.

[57] *Supra* note 18.

[58] 48 P.U.R.3d at 399.

disposal of depreciable items, and these are indeed used as offsets to depreciation, under the heading of 'salvage' ".[59] Later, in *D.C. Transit System, Inc.* (Order No. 563),[60] the Commission, in finding no connection between Transit's track removal and repaving program and its sale of its Georgia and Eastern Terminal,[61] concluded that "the ratepayer is not entitled to share in any portion of the proceeds of that sale, unless there was a profit on the depreciable portion of the asset sold,"[62] and found that "[t]here was none in this case."[63] And even after issuance of the order under review, the Commission has declared that "[t]here is no question that, when depreciable operating property is sold and a gain is realized, the gain should be used to reduce the depreciation expenses which ratepayers have paid but which the company, because of the gain, does not actually incur."[64]

In the District, then, the law on the topic immediately under discussion is already somewhat developed. Capital gains realized on disposition of depreciable assets while in service[65] do not automatically flow to Transit's investors,[66] although extraordinary circumstances may en-

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[59] *Id.* at 404.

[60] *Supra* note 18.

[61] See note 287, *infra*, and accompanying text.

[62] 63 P.U.R.3d at 34.

[63] *Id.*

[64] *D.C. Transit Sys., Inc.* (Order No. 1090), 85 P.U.R.3d 508, 513 (WMATC 1970).

[65] It may, of course, be that in given situations no gain is realized. That was so in *D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 18, discussed in text *supra* at notes 60-63.

[66] This is clear from all of the decisions in the District.

able them to share.[67] On the contrary, Transit's farepayers have a protectible interest in such gains which extends at the very least, to the amount of depreciation which has been charged to farepayers and may well extend far beyond.[68]

B. *Nondepreciable Assets*

The question whether a gain on disposition of nondepreciable assets inures to investors as capital surplus, or to consumers as a reduction in cost of service, has been litigated even less frequently than has the question in relation to depreciable assets. A survey of the few cases in point outside the District of Columbia reveals, somewhat paradoxically, a central strand of harmony amid diverse results. The decisions within the District—all administrative—have reached a uniform result, but without critical analysis either of the problem or the precedents.

—Out-of-District Cases

In *New York Water Service Corporation* v. *Public Service Commission*,[69] a utility sold, at a handsome profit, land which had outworn its usefulness as a storage reservoir. Its regulatory agency held that for ratemaking purposes the net profit reaped on the sale should be passed on to its customers.[70] On judicial review, that adjudica-

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[67] As in *D.C. Transit Sys., Inc.* (Order No. 4577), *supra* note 33. See text *supra* at notes 39-41.

[68] As in *D.C. Transit Sys., Inc.* (Order No. 4577), *supra* note 33. See text *supra* at notes 47-50.

[69] 12 App.Div. 122, 208 N.Y.S.2d 857 (1960).

[70] *New York Water Serv. Corp.*, 7 P.U.R.3d 32 (N.Y. Pub. Serv. Comm'n 1955). The commission felt that amortization of the profit from the sale over a seventeen-year period was "the most equitable method of meeting the problem." *Id.* It directed the utility to transfer the amount of the profit from

tion was sustained.[71] The court explained:

> The uniform system of accounts approved by the Commission applicable to water companies in dealing with land used for utility purposes allows land sold at a loss to be debited to the depreciation reserve and thus increase the rate base. If land is sold at a profit, it is required that the profit be added to, i.e., "credited to", the depreciation reserve, so that there is a corresponding reduction of the rate base and resulting return. The utility is thus protected from a loss in the sale of the land in its operations; it seems reasonable it should pass on a profit to the consumer.[72]

As the opinion on review makes plain, the guiding principle was that the gain belonged to those—investors or consumers—who previously bore the risk of loss from possible decline in market value.

In *City of Lexington* v. *Lexington Water Company*,[73] the pertinent facts were similar. The utility had acquired land which for many years it used to collect water for reservoirs, but when the reservoirs became inadequate the land was retired from service and removed from the utility's rate base. Somewhat later, the land was sold,[74]

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surplus to a reserve account and in each future year to amortize one-seventeenth against the depreciation accruals charged to operations. *Id.*

[71] *New York Water Serv. Corp.* v. *Public Serv. Comm'n, supra* note 69, 208 N.Y.S.2d at 863-64.

[72] *Id.* at 864

[73] 458 S.W.2d 778 (Ky. 1970).

[74] Neither of the two published opinions in the case informs as to the time interval between the retirement of the property from service and its sale. Assuming, without deciding, that any appreciation in its value after retirement belonged to the utility investors, there would remain the question whether appreciation prior thereto would inure to the benefit of its customers.

and the utility distributed the very considerable profit realized thereon to its investors as dividends.[75] When the utility subsequently sought a rate increase, its regulatory agency ruled that its consumers were entitled to the gain.[76] The agency, articulating essentially the same rationale espoused in *New York Water Service Corporation*, elucidated:

> The question arises, should this gain, made on property devoted to the public service over the years, be used to reduce the cost of service to the customers or should it be treated as a capital surplus item, and be allowed to be paid out to the stockholders. . . ? Having considered the evidence and arguments relating to this matter, we are of the opinion that it should be used to reduce the cost of service to the consumer.
>
> The subject property was not purchased by the utility as a land speculation but it was acquired for providing utility service to the public over the years and was subject to acquisition by condemnation.[77] Inasmuch as utility property necessary for rendering service to the public is not subject to sale at the option of the utility, but must be continued in service as long as needed to provide that service, any loss

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[75] By the agency's computation, the total net profit was $2,415,846, of which $138,791 was attributable to miscellaneous improvements on the land. The latter portion of the profit invites the problem of allocation of capital gains on depreciable property. See Part II(A), *supra*. On judicial review of the agency's decision, *City of Lexington* v. *Lexington Water Co.*, *supra* note 73, the court did not distinguish between the two portions of the $2,415,846.

[76] *Lexington Water Co.*, 72 P.U.R.3d 253 (Ky. Pub Serv. Comm'n 1968).

[77] On review of the decision, the court stated that there was a dispute as to whether the land had been acquired by condemnation or the threat thereof. 458 S.W.2d at 778. The court was of the opinion, however, that "whether the property was acquired by threats of use of the power of eminent domain [is] irrelevant." *Id.* at 779.

> in service value of such property would properly be considered a cost of providing service and, in the case of depreciable property, is recovered through depreciation. . . . For nondepreciable property, where the change in service value cannot be determined until actual disposition of the property, amortization of an allowable loss or gain would be the proper procedure. . . . If it is proper to recover losses of nondepreciable property through amortization, then conversely it should be proper to amortize gains on such property.[78]

On review, however, it was held that the agency's ruling was erroneous. The court distinguished *New York Water Service Corporation*[79] on the ground of a difference in the accounting methods respectively employed by New York and Kentucky regulatory authorities.[80] The Kentucky agency had adopted a system of accounts providing for the charging of losses and for the crediting of profits on land sales, not to customers, but rather to the utility's surplus account.[81] On that premise, the court apparently believed that the risk of capital gain or loss had actually been borne entirely by the utility's investors. On so much of the case, the court would seemingly have sustained the agency had the risk been on the utility's consumers.[82]

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[78] *Lexington Water Co., supra* note 76, 72 P.U.R.3d at 259-60.

[79] *Supra* note 69.

[80] For the New York practice, see text *supra* at note 72.

[81] 458 S.W.2d at 779.

[82] The court, however, also relied upon a passage in *Board of Pub. Util. Comm'rs* v. *New York Tel. Co.*, 271 U.S. 23, 32 (1926):

> Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not

In the only other reported decision we have found, the problem was presented only obliquely. In *Columbus Gas & Fuel Company* v. *Public Utilities Commission*,[83] the utility claimed that its annual depreciation allowance for depreciable property other than well-structures and equipment was inadequate because some items, consisting in land and rights of way, had been omitted from the computation.[84] The Court denied the claim but in doing so indicated that under different conditions the claim might well have been valid.[85] In relevant part the Court said:

> Certainly lands and rights of way may not be characterized as wasting assets in the absence of explana-

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acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.

And from that the Court further concluded that "[p]rofit made from the sale of non-depreciable land no longer used in serving customers is not an ingredient to be considered in fixing rates. The customers had no interest in the profit realized on the sale—it belonged to the stockholder" 458 S.W.2d at 780. In our view, *New York Telephone Company* hardly sustains that proposition. There the Supreme Court addressed the question whether consumers could benefit from excessive depreciation, taken by a utility in prior years, through an offset that would produce lower future rates. 271 U.S. at 26-31. The Court held that the assets representing the excess in the reserve for depreciation could not be used to make up a deficiency in current rates which rendered them confiscatory. *Id.* at 32. As the Court said, consumers do not acquire an interest in utility assets merely by paying their bills for service. *Id.* at 32. That is not to say that the utility's investors have an indefeasibly vested right to gains arising from the appreciated market value of capital assets. See discussion in Part III, *infra*.

[83] 292 U.S. 398 (1934).

[84] *Id.* at 410-11.

[85] *Id.* at 411.

> tion that would stamp that quality upon them. In saying this we do not forget that an abandonment of the business might bring about a sharp reduction in the value of the plant, aside from well-structures and equipment. There is nothing to show, however, that any such abandonment is planned or even reasonably probable. On the contrary, the course of business makes it clear that when the fields in use shall be exhausted, the business will extend to others, and this for an indefinite future, or certainly a future not susceptible of accurate estimation.[86]

As the Court indicated, a loss on the investment in nondepreciable elements of the utility's plant resulting from an unavoidable abandonment of its business would have been recognized if it had occurred, and that loss would then have been chargeable to its consumers.[87] One might easily reason from this premise that an appreciation in value of the nondepreciable elements would likewise become cognizable, and properly would redound to the benefit of the consumers.

In sum, the decisions outside the District have not viewed capital gains on in-service nondepreciable utility assets as inevitably belonging to investors to the exclusion of consumers. Rather, in each of the cases—although they are few—the allocation has depended upon location of the risk of loss. These holdings, then, may be accepted as applications of the broader principle that the benefit of a capital gain follows the risk of capital loss.[88] So read, they have our approbation.

—District Cases

The allocation properly to be made of in-service appreciations in value of Transit's nondepreciable assets is an

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[86] *Id.*

[87] See Part IV(A), *infra*, at notes 211-18.

[88] See Part IV(A), *infra*, at notes 181-90.

open question in this jurisdiction. Although both the Commission and PUC, its predecessor in transit regulation, have occasionally spoken to the subject, this court has never before been called upon to face the issue. Our analysis of the administrative decisions—which have uniformly viewed such gains as belonging to Transit's investors—discloses that they leave a great deal to be desired.

In early 1959, as we have related, Transit received $3,320,000 from the sale of its Fourth Street Shops and Southern Carhouse to the District of Columbia Redevelopment Land Agency.[89] Of a total net profit on the transaction of $2,181,363.08,[90] $950,568.55 was attributable to land.[91] In *D.C. Transit System, Inc.* (Order No. 4577),[92] PUC resolved a dispute between Transit and PUC's staff as to the accounting treatment to be accorded the capital gain on the *depreciable* subject matter of the sale. At the outset, however, PUC declared that it could "dispose of one item not in controversy."[93] It did, thusly:

> The staff and the company are in agreement that under public utility accounting, the difference between the original cost of land and the selling price is recognized as profit. The net profit of $950,568.55 on the sale of the land (net proceeds of $1,039,657.72 less original cost of $89,089.17) is, therefore, a proper credit to earned surplus.[94]

We readily understand that the $950,568.55, as PUC held, was net profit traceable to sale of the land. We are

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[89] See Part II(A), *supra* at notes 33-55.

[90] See Part II(A), *supra* at note 35.

[91] See note 36, *supra*.

[92] *Supra* note 33.

[93] 30 P.U.R.3d at 409.

[94] *Id.*

not nearly so clear, however, as to why PUC was confident that it was "therefore a proper credit to earned surplus." In other words, PUC does not tell us why it felt that the profit automatically belonged to investors. It may be that since the treatment to be given it was "not in controversy,"[95] PUC deemed it a simple, indubitable accounting problem. In any event, we are left with our doubts.

Order No. 4577 was later to come under judicial review by this court, but not in the aspect just discussed. By suit brought in the District Court for the District of Columbia, Transit attacked PUC's disposition of the profits allocable to the *depreciable* portion of the property sold.[96] Losing in that effort, Transit applied to this court, which affirmed.[97] Our action, of course, did not encompass PUC's ruling as to the gain realized on the land, for that ruling, favorable to Transit, was not brought before us. Still later, in *D.C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission*,[98] the sale of the same property was given attention by this court but, again, only in reference to the administrative disposition of the profits on the *depreciable* part.[99]

In *D.C. Transit System, Inc.* (Order No. 245),[100] the only other relevant decision in this jurisidction, it was ar-

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[95] Since the only party to the proceeding was Transit, no such "controversy" was likely unless generated by the Commission itself.

[96] See Part II(A), *supra*, at note 55.

[97] *D.C. Transit System, Inc.* v. *Public Utils. Comm'n*, *supra* note 51.

[98] *Supra* note 18.

[99] See 134 U.S.App.D.C. at 396-97, 350 F.2d at 774-75. See also the discussion in Part II(A), *supra*, at notes 52-55.

[100] *Supra* note 18.

gued to the respondent Commission, without avail, that Transit's losses on the premature retirement of rail facilities [101]—which the Commission has passed on to Transit's farepayers [102]—might be offset by gains which Transit realized upon the sale of certain real estate.[103] The properties sold were, again Transit's Fourth Street Shops and Southern Carhouse [104] and its Georgia and Eastern Terminal.[105] From aught that appears, nothing more than allocation of the net profit attributable to the *depreciable* portion of these properties was placed in issue before the Commission, and surely the decision on our review was that narrowly limited.[106] The Commission had, nevertheless, ventured a statement on the question as to which we are now analyzing the precedents. The Commission believed that "[i]t is a cardinal principle of regulatory law that a utility is not entitled to recover through depreciation charges or other accounting devices its investment in land." [107] "This principle," the Commission continued, "stems from the fact that in some instances the value of

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[101] These were facilities acquired by Transit from its predecessor, Capital Transit Company. Transit's franchise required that it convert to an all-bus operation, see notes 42, *supra*, and 237, *infra*, and accompanying text, and in the process the facilities in question became obsolete. See the discussion in Part IV(B), *infra*, at notes 277-300.

[102] See Part IV(B), *infra*, at notes 243-44.

[103] 48 P.U.R.3d at 403-04.

[104] See Part II(A), *supra*, at notes 33-35, and this Part, *supra*, at notes 89-99.

[105] See Part II(A), *supra*, at notes 61-63.

[106] See *D.C. Transit Sys., Inc.*. v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 18, 121 U.S.App.D.C. at 396-98, 350 F.2d at 774-76.

[107] 48 P.U.R.3d at 399.

land appreciates and in other instances depreciates."[108] So, the Commission said "[w]hile the ratepayers have a claim to depreciable property, at least to the extent of the depreciation reserves, no such claim can be directed to land."[109]

We are unable to follow this course of reasoning. With a paucity of holdings, administrative or judicial, on the point, we have not detected a hard-and-fast rule one way or the other.[110] Nor can we understand how the economic fact that land values may trend upward or downward can support the position on appreciation which the Commission assumed. The value of depreciable property, including depreciable improvements on land, also rises and falls with changing market conditions, and yet it is clear that consumers may contend for any capital gain achieved while it was used in service to the public.[111] What seeps through the Commission's discussion, however, is the conviction that the Commission has yet to consider factors which, at least in Transit's instance, bear importantly on the problem.

III

INTEREST OF INVESTORS IN VALUE-APPRECIATION IN OPERATING UTILITY ASSETS

We perceive no impediment, constitutional or otherwise, to recognition of a ratemaking principle enabling rate-

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[108] *Id.*

[109] *Id.*

[110] The Commission, like the Court in *Lexington Water Company*, see note 76, *supra*, felt that *Board of Pub. Util. Comm'rs* v. *New York Tel. Co.*, *supra* note 82, "clearly resolves the issue raised in this case concerning the proceeds from nondepreciable property." 48 P.U.R.3d at 400. We think otherwise. See note 82, *supra*, and Part III, *infra*.

[111] See Part II(A), *supra*.

payers to benefit from appreciations in value of utility properties accruing while in service. We believe the doctrinal consideration upon which pronouncements to the contrary [112] have primarily rested has lost all present-day vitality. Underlying these pronouncements is a basic legal and economic thesis—sometimes articulated, sometimes implicit—that utility assets, though dedicated to the public service, remain exclusively the property of the utility's investors, and that growth in value is an inseparable and inviolate incident of that property interest.[113] The precept of private ownership historically pervading our jurisprudence led naturally to such a thesis, and early decisions in the ratemaking field lent some support to it; if still viable, it strengthens the investor's claim. We think, however, after careful exploration, that the foundations for that approach, and the conclusion it seemed to indicate, have long since eroded away.

A. *In Rate Base Formulation*

Judicial indulgence in the concept that appreciation in value of utility property is an increment automatically attaching to its ownership reached its high water mark during the "fair value" era of rate-based formulations of returns to utilities.[114] In its 1898 decision in *Smyth* v.

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[112] See *D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 18, discussed in Part II(A), *supra*, at notes 60-64; *D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 18, discussed in Part II(B), *supra*, at notes 100-11; *D.C. Transit Sys., Inc.* (Order No. 4577), *supra* note 33, discussed in Part II(A), *supra*, at notes 33-50; *City of Lexington* v. *Lexington Water Co.*, *supra* note 73, discussed in Part II(B), *supra*, at notes 73-82.

[113] See cases cited *supra* note 112.

[114] See generally, 1 A. Priest, Principles of Public Utility Regulation 139 *et seq.* (1969); J. Bonbright, Principles of Public Utility Rates 159 *et seq.* (1961). To be distinguished is the operating ratio method of computing return. See note 266, *infra*, and accompanying text.

Ames,[115] the Supreme Court held "that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanctions must be the fair value of the property being used by it for the convenience of the public."[116] "[I]n order to ascertain that value," the Court said, "the original cost of construction, the amount expended in permanent improvements, . . . the present as compared with the original cost of construction, . . . are all matters for consideration, and are to be given such weight as may be just and right in each case."[117] And "[w]hat the company is entitled to ask," the Court continued, "is a fair return upon the value of land which it employs for the public convenience."[118]

Despite the Court's specification in *Smyth* v. *Ames* of original cost as well as reproduction cost as a factor to be considered in determining rate base value, the Court's decided preference during almost the next half-century was a reproduction cost formula.[119] This meant, of course, that in times of rising prices, the use of reproduction cost to the exclusion of original cost advantaged the utility's investors and disadvantaged its consumers. In 1908, in *Will-*

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[115] 169 U.S. 466 (1898).

[116] *Id.* at 546.

[117] *Id.* at 546-47.

[118] *Id.* at 547.

[119] For application of the formula in various contexts, see *West* v. *Chesapeake & Potomac Tel. Co.*, 295 U.S. 662, 671 (1935); *St. Louis & O'F Ry.* v. *United States*, 279 U.S. 461, 487 (1929); *McCardle* v. *Indianapolis Water Co.*, 272 U.S. 400, 408-09 (1926); *Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Serv. Comm'n*, 262 U.S. 276, 288 (1923); *Minnesota Rate Cases (Simpson v. Shepard)*, 230 U.S. 352, 354 (1913); *Willcox* v. *Consolidated Gas Co.*, 212 U.S. 19, 41, 52 (1909).

cox v. *Consolidated Gas Company*,[120] the Court remarked that "[i]f the property which legally enters into consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase."[121] Five years later, in the *Minnesota Rate Cases*,[122] the Court observed that the utility's "property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law."[123] And as late as 1926, in *Board of Public Utility Commissioners* v. *New York Telephone Company*,[124] the Court stated that "[c]ustomers pay for service, not for the property used to render it . . . [b]y paying bills for service they do not acquire any interest, legal or equitable, in the property used for the convenience or in the funds of the company."[125] Expressions of this sort encourage the idea that investors were entitled to all the benefits of value-growth of utility assets, of which the base for their rate of return was only one.

The fair value theory, however, was not to survive as the inexorable standard for setting rate base. Perhaps the turning point in conceptualization of the rights of investors viz-a-viz consumers in utility property occurred in 1923. In that year, Justice Brandeis, in his celebrated separate opinion in *Southwestern Bell Telephone Company*,[126] rejected the fair value approach to ratemaking and ad-

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[120] *Supra* note 119.

[121] 212 U.S. at 52.

[122] *Supra* note 119.

[123] 230 U.S. at 454.

[124] *Supra* note 82.

[125] 271 U.S. at 32.

[126] *Supra* note 119, 262 U.S. at 289. Justice Holmes joined in the opinion.

vanced a new basic concept:

> The thing devoted by the investor to the public use is not specific property, tangible or intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.[127]

Justice Brandeis' formula for ascertaining rate base—the amount of capital prudently invested—was not to become the prevailing rule.[128] But what has since prevailed is the central idea that the investor's legally protected interest resides in the capital he invests in the utility rather than in the items of property which that capital purchases for provision of utility service. In 1933, the Court sustained a rate base valuation from which reproduction cost had been excluded,[129] and five years later the Court upheld another valuation founded upon historical cost alone.[130] In 1942, in *Federal Power Commission* v. *Natural Gas Pipeline Company*,[131] the Court more formally abandoned reproduction cost when it ruled that "[t]he Constitution does not bind rate-making bodies to the service

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[127] *Id.* at 290 (footnote omitted).

[128] The prudent investment theory has, however, seen service in the District of Columbia. In *Washington Gas Light Co.* v. *Baker*, 88 U.S.App.D.C. 115, 188 F.2d 11 (1950), *cert. denied*, 340 U.S. 952 (1951), where PUC had applied that theory in lieu of reproduction costs, *id.* at 123, 188 F.2d at 19, we pointed out that "[p]rimary emphasis is now being placed not on 'specific property, tangible and intangible,' but on capital prudently invested and embarked on an enterprise in the public service." *Id.* (footnote omitted).

[129] *Los Angeles Gas Co.* v. *Railroad Comm'n*, 289 U.S. 287, 295-97 (1933).

[130] *Railroad Comm'n* v. *Pacific Gas Co.*, 302 U.S. 388, 399, 405 (1938).

[131] 315 U.S. 575 (1942).

of any single formula or combination of formulas." [132] Finally, in 1944, in *Federal Power Commission* v. *Hope Natural Gas Company*,[133] the Court rejected the Fourth Circuit's conclusion that the utility's rate base should reflect the "present fair value" of its property.[134] "'[F]air value,'" it said, "is the end product of the process of rate-making not the starting point as the Circuit Court of Appeals held." [135] "Under [a] statutory standard of 'just and reasonable,'" [136] it added, "it is the result reached not the method employed which is controlling. . . . It is not the theory but the impact of the rate order that counts." [137] This approach to rate base formulation is the prevailing doctrine today.[138]

The teaching of the modern cases in this area is plain. If investors in a public utility possessed an indefeasible

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[132] *Id.* at 586.

[133] 320 U.S. 591 (1944).

[134] See *Id.* at 599-600.

[135] *Id.* at 601. It seems clear that *Hope Natural Gas* thus adopted the investment concept which Justice Brandeis had espoused in *Southwestern Bell*. See text *supra* at note 127. See also 2 A. Priest, Principles of Public Utility Regulation 503-04 (1969).

[136] The quoted language is from the Natural Gas Act of 1938, 52 Stat. 821 (1938), §§ 4(a), 5(a), 15 U.S.C. §§ 717c(a), 717d(a) (1970). The Commission is required to apply exactly the same standard in promulgating Transit's fares. Compact, *supra* note 12, tit. II, art. XII, § 6(a)(3).

[137] 320 U.S. at 602.

[138] See, in addition to cases cited *supra*, *FPC* v. *Natural Gas Pipeline Co.*, *supra* note 133, 315 U.S. at 586; *Permian Basin Area Rate Cases (Continental Oil Co.* v. *FPC)*, 390 U.S. 747, 800 (1968). As to the District of Columbia, see note 128, *supra*, and, as to the states, I A. Priest, Principles of Public Utility Regulation 142-66 (1969).

right to the appreciation in value of the utility's operating assets, the base on which their rate of return is computed—the aggregate of the assets themselves—could be set only at the true value of the assets at the moment of setting. Fairness would suggest that result and due process would seem to compel it.[139] But it is now clear that the utility is not entitled of right to have its rate base established at the value which the assets would command on the current market, although that market value exceeds original cost. This can mean only that the investors' legally protected interest in such assets does not inexorably extend to the increment in value.

B. *In Depreciation Base Formulation*

The rise and fall of fair value as the exclusive method of measuring utility rate base has been paralleled by judicial treatment of the interrelated problem of basis for depreciation of utility assets. An integral part of the process of establishing a rate base for purposes of rate of return is ascertainment of the amount to be deducted from rate base—and, of course, allowed as an operating expense—for depreciation[140] of the utility's in-service property.[141] And if appreciation in the value of utility property is to invariably inure to the benefit of investors, it would logically follow that allowances for depreciation

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[139] See, *e.g.*, *Minnesota Rate Cases (Simpson* v. *Shepard)*, *supra* note 119, 230 U.S. at 454, quoted in text *supra* at note 123.

[140] See note 18, *supra*.

[141] "Annual depreciation is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is, in the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered." *Lindheimer* v. *Illinois Bell Tel. Co.*, 292 U.S. 151, 167 (1934) (footnote omitted).

must be computed on present value rather than acquisition cost or some other basis.

That was the view to which the Supreme Court originally subscribed. In 1909, in *Knoxville* v. *Knoxville Water Company,*[142] the Court decided that the utility "is entitled to see that from earnings the value of the property invested is kept unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning."[143] "It is," the Court said, "not only the right of a company to make such a provision but it is its duty to its bond and stockholders, and, in the case of a public service corporation at least, its plain duty to the public."[144] Two decades later, the Court, in *United Railway and Electric Company* v. *West,*[145] upheld a ruling that annual depreciation allowances were to be calculated on the basis of present value rather than cost.[146] Repeating the theme of *Knoxville Water Company,* a majority of the Court[147] referred to its then "settled rule" that rate base was to be established at present value,[148] and argued that "it would be wholly illogical to adopt a different rule for depreciation."[149]

Fair value, as the basis for depreciation, however, was later to go the way of fair value as the measure of rate

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[142] 212 U.S. 1 (1909).

[143] *Id.* at 13-14.

[144] *Id.* at 14.

[145] 280 U.S. 234 (1930).

[146] *Id.* at 253-54.

[147] Justice Brandeis, with whom Justice Holmes concurred, dissented. 280 U.S. at 254.

[148] See Part III (A), *supra.*

[149] 280 U.S. at 254.

base.[150] By 1934, in *Lindeheimer* v. *Illinois Bell Telephone Company*,[151] the Court upheld the propriety of computing annual depreciation on original cost.[152] The Court pointed out that "if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return."[153] And by 1942, in *Federal Power Commission* v. *Natural Gas Pipeline Company*,[154] the Court had sustained an amortization basis for depletable utility property calculated on capital investment rather than reproduction cost.[155] There the Court stated:

> When the property is devoted to a business which can exist only for a limited term, any scheme of amortization which will restore the capital investment at the end of the term involves no deprivation of property. Even though the reproduction cost of the property during the period may be more than its actual cost, this theoretical accretion to value represents no profit to the owner, since the property dedicated to the business, save for its salvage, is destined for the scrap-heap when the business ends. The Constitution does not require that the owner who embarks in a wasting-asset business of limited life shall receive at the end more than he has put into it.[156]

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[150] See Part III(A), *supra*.

[151] *Supra* note 141.

[152] 292 U.S. at 168-69.

[153] *Id.* at 169.

[154] *Supra* note 131.

[155] 315 U.S. at 592-93.

[156] *Id.* at 593.

Finally, in *Federal Power Commission* v. *Hope Natural Gas Company*,[157] in 1944, the Court upheld depreciation and depletion allowances based on cost,[158] overruling *United Railway and Electric Company* v. *West* in the process.[159] "By such a procedure," said the Court, "the utility is made whole and the integrity of its investment maintained. No more is required."[160]

Here again we draw a lesson from the jural history of ratemaking. Investors are entitled to recover the utility's outlay in the assets employed in provision of the utility's public service.[161] If the investors' protected interest in those assets encompassed increases in their market value, it would necessarily follow that the recoupment must embrace the increases as well as the amount laid out for their acquisition. But it is now clear that the amount of eventual recovery—the depreciation base—may permissibly be limited to the amount of the original outlay. This is but another way of saying that the investors do not possess a vested right in value-appreciations accruing to in-service utility assets.

C. *In Transit's Ratemaking Litigation*

The considerations just explored take on added weight in Transit's case, for fair value has never been assigned a role in determinations as to its rate or depreciation bases. That it was not an ingredient of either was settled rather early in Transit's regulatory history. In the days prior to utilization of the operating ratio method in computa-

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[157] *Supra* note 133.

[158] 320 U.S. at 606.

[159] *Id.* at 606-07.

[160] *Id.* at 606.

[161] See text *supra* at notes 142-44.

tions of its margins of return,[162] the Commission's predecessor, PUC, established and maintained Transit's rate base without consideration of the then present value of its in-service properties.[163] In those days, PUC also employed original cost as the formula for setting Transit's depreciation base,[164] and the Commission in its turn, has done the same.[165] Neither for purposes of its rate base nor its basis for depreciation, then, has appreciation in the market value of its assets been deemed a benefit to which Transit's investors might justly lay claim.

But that was not because the effort was not made. In a fare-increase proceeding inaugurated in 1960, Transit sought to persuade PUC to adopt a depreciation base combining replacement cost for some properties with market value for others.[166] PUC, however, declined to do so.[167] Instead, PUC pointed out that it has "long held that original cost is the only sound basis for measuring depreciation as it is in accord with the fundamental purpose of depreciation accounting, namely, to recover the cost of invest-

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[162] See note 266, *infra*.

[163] See note 266, *infra*.

[164] See *D.C. Transit Sys., Inc.* (Order No. 4631), 33 P.U.R. 3d 137, 155 (D.C. Pub. Utils. Comm'n 1960), wherein PUC established Transit's acquisition adjustment account, discussed in text *infra* at notes 251-56, a device which incorporated original cost rather than present value as the basis for depreciation. See also *D.C. Transit Sys., Inc.* (Order No. 4735), 38 P.U.R.3d 19, 34-35 (D.C. Pub. Utils. Comm'n 1961) (rejecting replacement cost), discussed in text *infra* at notes 167-70.

[165] See, *e.g., D.C. Transit Sys., Inc.* (Order No. 984), 81 P.U.R.3d 417, 427 (WMATC 1969).

[166] *D.C. Transit Sys., Inc.* (Order No. 4735), *supra* note 164, 38 P.U.R.3d at 34.

[167] *Id.* at 34-35.

ment rather than to provide for the cost of replacement." [168] "The use of replacement cost as a base for the calculation of depreciation allowances," in PUC's view, "has many serious faults," [169] not the least of which is the distinct possibility that Transit's farepayers would thereby be made involuntary contributors to its capital. PUC explained:

> [I]f prices are rising the use of the replacement cost base would compel consumers to provide additional capital for the utility, at least to the extent that replacement costs were greater than the costs of the depreciating equipment. [Transit's witness] admitted that under his theory consumers would be in the position of involuntary investors though with no right to a return on their investment; and what is even worse, they would thereafter be required to provide a fair return and depreciation allowance on capital which they themselves had contributed. Obviously, consumers' obligations end when they have paid the cost of service including the cost of the depreciable assets used and exhausted in rendering that service. The original cost base is just and equitable for both investors and consumers. Consumers pay the cost of service including the cost of capital. To ask the consumers to pay more than the cost is to make them contribute to the capital of the enterprise.[170]

We cannot, then, accept the thesis that appreciations in value of Transit's properties while in operating status automatically flow to Transit's investors as inseparable incidents of ownership. To be sure, investors are entitled to have rates fixed with a view to a fair return on their investment,[171] and to have depreciation allowances set in

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[168] *Id.* at 34.

[169] *Id.*

[170] *Id.* at 34-35.

[171] *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, —— U.S.App.D.C. ——, ——, 466 F.2d 394, 418-19, *cert. denied*, 409 U.S. 1086 (1972).

contemplation of eventual recoupment of their investment in toto.[172] But modern ratemaking doctrine militates against the proposition that value-appreciation alone can legitimately increase either the return[173] or the recoupment.[174] Indeed in Transit's case it never has,[175] and that would have been legally impossible if the investors' protected interest in Transit's assets extended to advances in market value as well as to the original investment in them. The fact is that Transit's investors have been so limited in both respects, and that serves adequately to refute any notion that they necessarily possess a claim on such advances.[176]

IV

BASIS FOR ALLOCATION OF CAPITAL GAINS ON OPERATING UTILITY ASSETS

Investors, we have concluded, are not automatically entitled to gains in value of operating utility properties simply as an incident of the ownership conferred by their investments. And it goes without saying that consumers do not succeed to such gains simply because they are users of the service furnished by the utility. Neither capital invest-

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[172] See Part III(A), *supra*.

[173] See Part III(B), *supra*.

[174] See Part III(B), *supra*.

[175] See text *supra* at notes 162-70.

[176] Indeed, claims of utility investors, including Transit's, on appreciations in value of depreciable utility assets have generally been subordinated to the claims of the utility's consumers. See Part II(A), *supra*. That, we believe, is a consequence, rather than a cause, of the investors' lack of an indefeasible right to the appreciations. But it is evident that consumers could never have enjoyed priority, or even a measure of equality, if the investors' right were absolute.

ment nor service consumption contributes in any special way to value-growth in utility assets. Rather, the values with which we are concerned have grown simply because of a rising market.

Investors and consumers thus start off on an equal footing, and the disposition of the growth must depend on other factors. We thus reach the dual critical inquiry: identification of the principles which must guide the allocation, as between investor and consumer groups, of appreciation in value of utility assets while in operating status; and application of those principles to Transit's situation.

A. *Doctrinal Considerations*

The ratemaking process involves fundamentally "a balancing of the investor and the consumer interests." [177] The investor's interest lies in the integrity of his investment and a fair opportunity for a reasonable return thereon.[178] The consumer's interest lies in governmental protection against unreasonable charges for the monopolistic service to which he subscribes.[179] In terms of property value appreciations, the balance is best struck at the point at which the interests of both groups receive maximum accommodation. We think two accepted principles which have served comparably to effect satisfactory adjustments in other aspects of ratemaking can do equal service here.

One is the principle that the right to capital gains on utility assets is tied to the risk of capital losses. The other

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[177] *FPC* v. *Hope Natural Gas Co., supra* note 133, 320 U.S. at 603.

[178] *E.g., id.*

[179] "[F]rom the earliest cases, the end of public utility regulation has been recognized to be protection of consumers from exhorbitant rates." *Washington Gas Light Co.* v. *Baker, supra* note 128, 88 U.S.App.D.C. at 119, 188 F.2d at 15 (footnote omitted).

is the principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom. The justice inherent in these principles is self-evident, and each already occupies a niche in the law of ratemaking;[180] and their application, sometimes overlapping, to the problem at hand weighs the scale heavily in favor of consumers. For practice in the utility field has long imposed upon consumers substantial risks of loss and financial burden associated with the assets employed in the utility's business. We will pause to examine the practices, and then their effect in conjunction with the principles mentioned.

—Right to Gain Follows Risk of Loss

A factor strongly influencing the rate of return to which the utility investor becomes entitled is the magnitude of the risk which his investment encounters.[181] High risks justify larger returns,[182] while low risks more nearly guarantee the investment, and so may warrant smaller returns.[183] Similarly, an investor can hardly muster any

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[180] See discussion in Part IV(A), *infra*.

[181] See, *e.g.*, *FPC* v. *Hope Natural Gas Co.*, *supra* note 133, 320 U.S. at 605; *Smith* v. *Illinois Bell Tel. Co.*, 282 U.S. 133, 160-62 (1930); *United Ry. & Elec. Co. v. West*, *supra* note 145, 280 U.S. at 249, 250; *Bluefield Water Works & Improvement Co.* v. *Public Serv. Comm'n*, 262 U.S. 679, 692-93 (1923); *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 355 nn. 64, 65, 415 F.2d at 935 nn. 64, 65.

[182] See *Atlantic Ref. Co.* v. *FPC*, 115 U.S.App.D.C. 26, 28, 316 F.2d 677, 679 (1963); *New Haven Water Co.*, 2 P.U.R.3d 452, 456-60 (Conn. Pub. Utils. Comm'n 1954). See also cases cited *supra* note 181.

[183] *FPC* v. *Hope Natural Gas Co.*, *supra* note 133, 320 U.S. at 604-05; *State ex rel. Pacific Tel. & Tel. Co.* v. *Department*

equitable support for a claim to appreciation in asset value where he has been shielded against the risk of loss on his investment, or has already been rewarded for taking on that risk.

The proposition that capital gain rightly inures to the benefit of him who bore the risk of capital loss has been accepted in ratemaking law. Thus, as we have seen, investors have been denied capital gains realized on disposition of utility assets where they have not borne the risk of loss associated with the holding of such assets.[184] And we have consistently held that investors cannot recover for underdepreciated assets where they have in some form been compensated either for the deficiency or for assuming the risk that a deficiency might occur.[185] On the other hand, grave risks associated with utility assets are commonly thrust upon consumers. Many are susceptible to loss or damage from acts of nature and man, and risks of such casualties are usually passed on to consumers.[186] The risk

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of Pub. Serv., 19 Wash.2d 200, 142 P.2d 498, 528 (*en banc* 1943); *Michigan Bell Tel. Co.* v. *Public Serv. Comm'n*, 332 Mich. 7, 50 N.W.2d 826, 840-41 (1952); *El Paso Natural Gas Co.*, 28 F.P.C. 688, 694-95, 45 P.U.R.3d 262, 270-71 (1962).

[184] See cases discussed *supra* in Part II(A).

[185] *Bebchick* v. *Washington Metropolitan Area Transit Comm'n*, 115 U.S.App.D.C. 216, 224, 318 F.2d 187, 195, *cert. denied*, 373 U.S. 913 (1963); *Williams v. Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S. App.D.C. at 374-76, 415 F.2d at 954-56; *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 123-25, 188 F.2d at 19-21. See also *Minneapolis St. Ry. Co.* v. *City of Minneapolis*, 251 Minn. 43, 86 N.W.2d 657, 665-68 (1957).

[186] See, *Northwestern Bell Tel. Co.*, 78 S.D. 15, 98 N.W.2d 170, 179 (1959); *Diamond State Tel. Co.*, 28 P.U.R.3d 121, 137-39 (Del. Pub. Serv. Comm'n 1959); *Baltimore Gas &*

of loss from premature retirement of assets because of obsolescence, as a general rule, also falls on consumers.[187] Moreover, in at least one jurisdiction, the possibility that a utility asset will diminish in market value while in service is a hazard which the consumer rather than the investor must face.[188] And, unlike casualty losses, those resulting from obsolescence and declining markets may occur with respect to nondepreciable as well as depreciable assets.[189] Some cases have already awarded value appreciations to consumers in such situations.[190]

In our view, the doctrine that capital gain accompanies the risk of capital loss is sound. The following example illustrates how this principle applies to land, which, while it may have lost its usefulness in a utility's operations, has nonetheless appreciated in value while in operating status. Let us suppose that fifteen years ago the company purchased a piece of property on which to construct a building to be used as its central offices. Under established principles of regulatory law, the loss from normal wear and tear on the building—a depreciable asset—would be recouped from its ratepayers by the investors, who are entitled to have their investment in an operating asset protected.[191] What

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Elec. Co., 25 P.U.R.3d 91 (Md. Pub. Serv. Comm'n 1959); *Florida Power & Light Co.*, 19 P.U.R.3d 417, 429 (Fla. R.R. & Pub. Util. Comm'n 1957); *Long Island Lighting Co.*, 7 P.U.R.3d 140, 141-42 (N.Y. Pub. Serv. Comm'n 1955).

[187] See text *infra* at note 201.

[188] See *New York Water Serv. Corp.* v. *Public Serv. Comm'n*, *supra* note 69, discussed in Part II(B), *supra*, at notes 69-72.

[189] See *id.*; *Columbus Gas & Fuel Co.* v. *Public Serv. Comm'n*, *supra* note 83, 292 U.S. at 411.

[190] See cases discussed in Part II(B), *supra*.

[191] See Part IV(A), *infra*, at note 199.

would happen if, because of a change in the character of the neighborhod or because of a need for increased office space, the building were no longer suitable for the utility's operations? If the building had to be sold at a loss, clearly the ratepayers, under the precepts articulated above, would bear the burden of covering that loss.[192] On the other hand, if a profit were made on the sale of the building, the gain would go to the ratepayers, at least to the extent necessary to recoup their payments for depreciation.[193]

As for the land on which the building is located, it is true that land does not depreciate from ordinary wear and tear the way a building does. But it is also true that the land in our example has become unsuitable—in business parlance, obsolete—for continued use in the company's operations. If it, like the building, must be retired from service and sold at a loss, who bears the onus of making up that loss? Since the investors may insist upon preservation of any investment they make in an asset to be used in the utility's operations, it is the ratepayers' burden to compensate them for the loss on their investment in the land.[194] Accordingly, if the land no longer useful in utility operations is sold at a profit, those who shouldered the risk of loss are entitled to benefit from the gain.[195]

The principle that capital gain follows risk of loss, useful as it may be, is not without its limitations. There may be situations where the assignment of risk of loss on a particular asset is not readily ascertainable, or where for some

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[192] See Part IV(A), *infra*, at notes 211-18.

[193] See Part II(A), *supra;* Part IV(A), *infra*, at notes 225-27.

[194] See Part IV(A), *infra*, at notes 211-18.

[195] See Part II(B), *supra*.

other reason the terminology "capital gains and losses" is inappropriate or inapposite.[196] In such a case the second doctrinal consideration we have mentioned—the precept that those who bear the financial burden of particular utility activity should also reap the benefit resulting therefrom —comes into play.

—Economic Benefit Follows Economic Burden

Ratepayers bear the expense of depreciation, including obsolescence and depletion,[197] on operating utility assets through expense allowances to the utilities they patronize.[198] It is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service.[199] This entitle-

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[196] See Part IV(B), *infra*, at notes 228-29.

[197] For definitions, see note 18, *supra*.

[198] *St. Joseph Stock Yards Co.* v. *United States*, 298 U.S. 38, 65-67 (1936); *Lindheimer* v. *Illinois Bell Tel. Co.*, *supra* note 141, 292 U.S. at 165-75; *Pacific Gas & Elec. Co.* v. *City & County of San Francisco*, 265 U.S. 403, 415-16 (1924); *Kansas City S. Ry.* v. *United States*, 231 U.S. 423, 449-52 (1913); *Minnesota Rate Cases (Simpson* v. *Shepard)*, *supra* note 119, 230 U.S. at 456-58; *Knoxville* v. *Knoxville Water Co.*, *supra* note 142, 212 U.S. at 9-11; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 18, 121 U.S.App.D.C. at 394-95, 350 F.2d at 772-73; *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S. App.D.C. at 123, 188 F.2d at 19; *FPC* v. *Hope Natural Gas Co.*, *supra* note 133, 320 U.S. at 605. See also the cases cited *infra* notes 201-02.

[199] *FPC* v. *Hope Natural Gas Co.*, *supra* note 133, 320 U.S. at 596-607; *United Rys. & Elec. Co.* v. *West*, *supra* note 145, 280 U.S. at 253-54; *Illinois Cent. R.R.* v. *ICC*, 206 U.S. 441, 461-63 (1907); *Smyth* v. *Ames*, *supra* note 115, 169 U.S. at 547; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 18, 121 U.S.App.D.C. at 394-95, 350 F.2d at 772-73; *Panhandle Eastern Pipe Line Co.* v.

ment extends, not only to reductions in investment attributable to physical wear and tear (ordinary depreciation)[200] but also to those occasioned by functional deterioration (obsolesence)[201] and by exhaustion (depletion).[202] Recoupment of investment, particularly where the reduction is gradual, is usually accomplished by annual or other periodic allowances, commonly referred to as depreciation expenses.[203] Recoupment may, however, be effected by a single charge, or by amortization of the investment loss against the ratepayers, as is more frequently done in instances of obsolescence and resulting abandonment of still, serviceable

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FPC, 113 U.S.App.D.C. 94, 305 F.2d 763 (1962), *cert. denied*, 372 U.S. 916 (1963); *City of Detroit* v. *FPC*, 97 U.S. App.D.C. 260, 263, 230 F.2d 810, 813 (1955), *cert. denied*, 352 U.S. 829 (1956); *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 119-20, 122-23, 188 F.2d at 15-16, 18-19; *Public Utils. Comm'n* v. *Capital Traction Co.*, 57 App.D.C. 85, 88, 17 F.2d 673, 676 (1927); *Safe Harbor Water Power Corp.* v. *FPC*, 179 F.2d 179, 193-99 (3d Cir. 1949), *cert. denied*, 339 U.S. 957 (1950); *City of Minneapolis* v. *Rand*, 285 F. 818, 825-31 (8th Cir. 1923).

[200] See cases cited *supra* note 198.

[201] *E.g.*, *Los Angeles Gas & Elec. Corp.* v. *Railroad Comm'n*, *supra* note 129, 289 U.S. at 306-07; *Pacific Gas & Elec. Co.* v. *City & County of San Francisco*, *supra* note 198, 265 U.S. at 406-16; *Kansas City S. Ry.* v. *United States*, *supra* note 198; *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 126, 188 F.2d at 22; *Colorado Interstate Gas Co.* v. *FPC*, 142 F.2d 943, 959-61 (10th Cir. 1944); *Minneapolis St. Ry.* v. *City of Minneapolis*, *supra* note 185, 86 N.W. 2d at 665-68.

[202] *E.g.*, *FPC* v. *Hope Natural Gas Co.*, *supra* note 133, 320 U.S. at 606 *et seq*; *Dayton Power & Light Co.* v. *Public Serv. Comm'n*, 292 U.S. 290, 303-05 (1934); *Arkansas-Louisiana Gas Co.* v. *City of Texarkana*, 17 F.Supp. 447, 460-63 (W.D. Ark. 1936).

[203] See cases cited *supra* notes 199, 201, 202.

assets.[204] In all cases, the expense levied against ratepayers is the difference between the original cost of the asset and its salvage value,[205] estimated or actual.[206]

Computations of the cost of ordinary depreciation—normal physical deterioration—are made on the basis of estimates of service life and salvage value, and charges therefor are usually spread over the service period.[207] Depletion allowances are similarly based on estimates of productive life, and usually are similarly spread.[208] Even obsolescence may sometimes be foreseen and calculated in much the same manner.[209] It is evident that if all predictions are accurate

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[204] *Consolidated Edison*, 56 P.U.R.3d 337, 371-77 (N.Y. Pub.Serv. Comm'n 1964) (losses incurred in retirement of plant amortized); *Lakewood Water Co.*, 78 P.U.R.3d 453, 457, 458 (N.J. Bd. of Pub. Util. Comm'rs 1968); *Missouri Cities Water Co.*, 53 P.U.R.3d 352, 354, 359-60 (Mo. Pub. Serv. Comm'n 1965) (plant with life expectancy of 50 years retired because of increasing saline content after only six years of operation amortized over 10-year period); *Howes* v. *Mather Water Co.*, 13 P.U.R.3d 486, 490-91 (Pa. Pub. Util. Comm'n 1956) (supply sources abandoned because of contamination amortized). See generally, *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 123-27, 188 F.2d at 19-23.

[205] See cases cited *supra* note 198.

[206] See cases cited *supra* notes 198, 199, 201, 204.

[207] As to the "service life theory of depreciation," see particularly *International Ry.* v. *Prendergast*, 1 F.Supp. 623, 627-31 (W.D.N.Y. 1932). See also cases cited *supra* note 204. Compare 1 A. Priest, Principles of Public Utility Regulation 117-24 (1969). In *D.C. Transit Sys., Inc.* (Order No. 4735), *supra* note 164, 38 P.U.R.3d at 35, the straight-line method of depreciation accounting, as opposed to the sum-of-digits method, was approved for ratemaking purposes.

[208] See cases cited *supra* note 202.

[209] See cases cited *supra* notes 201-04.

and the asset remains in service for precisely the period anticipated, the process will eventually yield to investors the exact amount of their investment, and will ultimately cost consumers the same amount. Consumers will thus absorb the investment loss and investors will be made whole.

But calculations, even of the highest predictive quality, sometimes go awry. Service life, productive life or salvage value may turn out to be more or less than originally estimated.[210] Obsolescence may be slower or faster than expected in the beginning,[211] or may arrive suddenly,[212] and damage to or destruction of the asset may occur just as suddenly.[213] In most instances, however, the consumers' financial obligation remains intact, the investors' right to

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[210] See *St. Joseph Stock Yards Co.* v. *United States, supra* note 198, 298 U.S. at 55-72; *Lindheimer* v. *Illinois Bell Tel. Co., supra* note 141, 292 U.S. at 168-75; *Williams* v. *Washington Metropolitan Area Transit Comm'n, supra* note 16, 134 U.S.App.D.C. at 371-76, 415 F.2d at 951-56; *Bebchick* v. *Public Utils. Comm'n, supra* note 185, 115 U.S.App.D.C. at 223-24, 318 F.2d at 194-95; *California-Pacific Utils. Co.*, 71 P.U.R.3d 270, 272 (Nev. Pub. Serv. Comm'n 1967).

[211] *Williams* v. *Washington Metropolitan Area Transit Comm'n, supra* note 16, 134 U.S.App.D.C. at 372-76, 415 F.2d at 952-56; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 18, 121 U.S.App.D.C. at 390-91, 350 F.2d at 768-69; *D.C. Transit Sys., Inc.* (Order No. 952), 80 P.U.R.3d 1 (WMATC 1969); *Maui Elec. Co.*, 74 P.U.R.3d 140, 147-50 (Hawaii Pub. Util. Comm'n 1968); *Honolulu Rapid Transit Co.*, 68 P.U.R.3d 409, 414 (Hawaii Pub. Serv. Comm'n 1967). Compare *D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 18, 48 P.U.R.3d at 405, 406 (allowing reduction in service-life period).

[212] *E.g.*, see cases cited *supra* note 204.

[213] *E.g.*, *Missouri Cities Water Co.* and *Howes* v. *Mather Water Co.*, both *supra* note 204.

recoupment remains unimpaired, and appropriate adjustments must be made.[214] This is so although in terms of original expectations, the loss of serviceability is premature.[215] Consumers bear the risk of that loss[216] unless investors have been compensated for assuming it;[217] if, as is more usual, investors have not, return of their investment is fully assured.[218]

In this milieu, the distribution of the risks and burdens on utility assets is apparent. Consumers must ordinarily bear the expense of normal maintenance[219] and, according

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[214] *E.g.*, *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 374-78, 415 F.2d at 954-58.

[215] See cases cited *supra* notes 211-13.

[216] See *FPC* v. *Hope Natural Gas Co.*, *supra* note 133, 320 U.S. at 603; *Bluefield Waterworks & Improvement Co.* v. *Public Service Comm'n*, *supra* note 181, 262 U.S. at 692-93. *Accord*, *Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *FPC*), *supra* note 138, 390 U.S. at 792; *Atlantic Ref. Co.* v. *FPC*, *supra* note 182, 115 U.S.App.D.C. at 27-28, 316 F.2d at 678-79.

[217] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 374-77, 415 F.2d at 954-57; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 18, 121 U.S.App.D.C. at 394-95, 350 F.2d at 772-73, *aff'g after remand* in *Bebchick* v. *Public Service Comm'n*, *supra* note 185, 115 U.S.App.D.C. at 224, 318 F.2d at 195; *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 123-24, 188 F.2d at 19-20.

[218] See cases cited *supra* note 217.

[219] *In re Northwestern Bell Tel. Co.*, 73 S.D. 37, 43 N.W.2d 553, 564 (1950), *cert. denied*, 340 U.S. 934 (1951); *D.C. Transit Sys., Inc.* (Order No. 564), 63 P.U.R.3d 45, 55 (WMATC 1966); *Cheyenne Light, Fuel & Power Co.*, 7 P.U.R.3d 129, 134 (Wyo. Pub. Serv. Comm'n 1955).

to some decisions, of deferred maintenance as well.[220] Beyond that, consumers must usually absorb the investment losses wrought by normal wear and tear on depreciable assets,[221] and by exhaustion of depletable assets.[222] Even when an asset is underdepreciated at the time it is retired from service, consumers must reimburse the investors therefor.[223] And when utility property becomes unsuitable by reason of obsolescence before investors have fully recouped their investment in it, the loss is passed on to consumers.[224]

In situations where consumers have shouldered these burdens on an asset which produces a gain, the equities clearly preponderate in their favor. This has been recognized in cases holding that rents received by a utility from the leasing of operating properties must be included in the utility's operating income.[225] More directly in point,

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[220] *E.g., Wall* v. *Public Util. Comm'n*, 182 Pa. Super. 35, 125 A.2d 630, 638-39 (1956); *Penn-York Natural Gas Co.*, 5 F.P.C. 33, 37, 63 P.U.R. (n.s.) 235, 238 (1946); *Lucerne Water Co.*, 52 P.U.R.3d 219, 224-25 (Cal. Pub. Util. Comm'n 1964).

[221] See cases cited *supra* note 198.

[222] See cases cited *supra* note 202.

[223] *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 123-24, 188 F.2d at 19-20; *Minneapolis St. Ry.* v. *City of Minneapolis*, *supra* note 185, 86 N.W.2d at 660-68.

[224] See cases cited *supra* note 201.

[225] *Fleming* v. *Illinois Commerce Comm'n*, 388 Ill. 138, 57 N.E.2d 384, 395 (1944), *appeal dismissed and cert. denied*, 324 U.S. 823 (1945); *Pekin Water Works Co.*, 82 P.U.R.3d 460, 466 (Ill. Commerce Comm'n 1970); *Illinois Commerce Comm'n* v. *Public Serv. Co.*, 4 P.U.R.(n.s.) 1, 27-30 (Ill. Commerce Comm'n 1934); *Hillsborough & M. Tel. Co.*, 14 P.U.R. 3d 212, 217 (N.J. Bd. Pub. Util. Comm'rs 1956); *Farmer's Union Tel. Co.*, 84 P.U.R. (n.s.) 82, 85 (N.J. Bd. Pub. Util. Comm'rs 1950); *Public Serv. Comm'n* v. *Mountain Fuel Sup-*

the cases, as we have seen, generally agree that consumers have the superior claim to capital gains achieved on depreciable assets while in operation [226] and this, we believe, is as it should be. Investors who are afforded the opportunity of a fair return on a secure investment in utility assets are hardly in position to complain that they do not receive their just due from the traveling public. On the other hand, it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and waste occurring in service, should benefit in instances where gain eventuates—to the full extent of the gain.[227]

B. *Application of Doctrine In This Case*

We direct our attention now to the situation presented at bar with a view to resolving the conflicting claims of

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ply Co., 73 P.U.R. (n.s.) 428, 441 (Utah Pub. Serv. Comm'n 1947).

[226] See discussion in Part II(A), *supra*.

[227] The Commission has recognized that Transit's farepayers are entitled to capital gains on depreciable assets withdrawn from service at least to the extent of reimbursement for their contributions to depreciation expenses on such assets. See Part II(A), *supra*, at notes 57-64. PUC, the Commission's predecessor, recognized that the farepayers' entitlement may extend beyond mere reimbursement, and this court has done so as well. See Part II(A), *supra*, at notes 33-50. We perceive no justification, absent extraordinary circumstances, for limiting farepayers to only a part of the gain. Their right to its benefit derives from the fact that they have borne the financial burden of loss of serviceability of the withdrawn assets and the risk that such loss might occur prematurely. Had the gain been too small to enable full reimbursement, they would have suffered the loss on the remainder. Elemental justice requires that they be awarded the full gain, even though it exceeds the amount necessary for reimbursement.

Transit's investors and farepayers to the capital gains in issue. At the outset, we lay aside the rule that capital gain accompanies risk of capital loss. As we point out today in No. 24,398, *Democratic Central Committee* v. *Washington Metropolitan Area Transit Commission*,[228] and as the Commission itself admits,[229] there has never been any risk of financial loss, actual or foreseeable, on the parcels of land which concern us here. Despite an ever-present risk of obsolescence of land for utility purposes, land values since acquisition of the properties by Transit have climbed steadily in the Nation's Capital, and throughout Transit's regulatory history could only have been expected to do so. So, while the risk of obsolescence is insoluble, the risk of any consequent financial loss has been foreclosed by the rising real estate market. It would be little more than an exercise in abstract logic to invoke the principle of gain-follows-loss where the financial risk is wholly illusory. Consequently, we confine ourselves to the second doctrinal consideration discussed—that benefit follows burden—in determining where the equities lie here. The exploration we find we must make is ramified, necessitating examination of the history of the acquisition of the questioned assets, the allocation of burdens and the accrual of advantages associated with the holding of those assets, and thereafter a balancing of the respective interests competing for the gains at stake. We undertake these tasks and, discharging them, we conclude that Transit's farepayers must prevail.

—Acquisition History And Allocation of Burdens

In 1956, Transit was awarded its franchise to operate a mass transportation system within the Washington met-

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[228] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 3, at nn. 101-06.

[229] Brief for Respondent at 13.

ropolitan area.[230] The franchise was conditioned upon Transit's acquisition of the assets of Capital Transit Company (Capital),[231] which for many years had served the area through a system in which both streetcars and buses were employed. Transit purchased Capital's assets and on August 15, 1956, commenced its own operation. The parcels of realty upon which this litigation centers were a part of Transit's acquisition from Capital.[232]

At the time of Transit's takeover, Capital's assets were valued on its books at approximately $23.8 million.[233] Transit's purchase price was about $13.5 million,[234] of which only $500,000 represented an actual cash investment.[235] The balance ultimately came partly from Capital's cash on hand and partly from the sale of certain of Capital's properties, but mostly from farebox revenues after Transit went into business.[236]

Transit's franchise imposed the requirement that Capital's streetcar-bus system be gradually converted into an all-bus system throughout the metropolitan area.[237] This

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[230] Pub.L. No. 757, 70 Stat. 598 (1956) (Franchise Act). See also H.R. Rep. No. 2751, 84th Cong., 2d Sess. (1956).

[231] *Id.* at tit. II, §§ 201(a), 202, 203.

[232] See appendix.

[233] S.Rep. No. 91-760, 91st Cong., 2d Sess. 3 (1970).

[234] *Id.; D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 158.

[235] S. Rep. No. 91-760, 91st Cong., 2d Sess. 3 (1970).

[236] *Id.*

[237] The Franchise Act, tit. I, pt. 1, § 7, 70 Stat. 598, 599 (1956), provides:

> The Corporation shall be obligated to initiate and carry out a plan of gradual conversion of its street railway operations to bus operations within seven years

program necessitated the removal of the abandoned streetcar tracks and the regrading and repaving of the abandoned track areas,[238] at an estimated cost of $10,441,958.[239] To accommodate that cost, PUC established a reserve for track removal and repaving,[240] and directed the accrual of $1,044,196 thereto annually for ten years.[241] And at an early stage in Transit's regulatory history, the question arose as to whether those accruals should be made by Transit's investors through capital contributions or from Transit's consumers in the form of higher fares.

This was an expense with two aspects, and the nature of each militated, in terms of ratemaking law, against the ratepayers. The first was the loss incidental to abandonment of the rail facilities which had passed from Capital to Transit. As we have pointed out, it has ofttimes been

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from the date of the enactment of this Act upon terms and conditions prescribed by the Commission, with such regard as is reasonably possible when appropriate to the highway development plans of the District of Columbia and the economies implicit in coordinating the Corporation's track removal program with such plans; except that upon good and sufficient cause shown the Commission may in its discretion extend beyond seven years, the period for carrying out such conversion. All of the provisions of the full paragraph of the District of Columbia Appropriation Act, 1942, (55 Stat. 499, 533), under the title "Highway Fund, Gasoline Tax and Motor Vehicle Fees", subtitle "Street Improvements", relating to the removal of abandoned track areas, shall be applicable to the Corporation.

[238] See District of Columbia Appropriation Act of 1942, 55 Stat. 499, 533 (1941).

[239] *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 155.

[240] *Id.*

[241] *Id.*

held that permanent losses on premature property retirements are to be amortized as operating expenses for future consumers to absorb.[242] In similar fashion, PUC, Transit's then regulatory agency, treated the undepreciated cost of the tracks and streetcars acquired by Transit as a part of the depreciation expense recoverable from its farepayers.[243] This item of cost was anticipated to aggregate more than $5 million.[244] The second aspect of the expense was the cost of removing the tracks, and regrading and repaving the street areas from which they were removed. That cost, too, PUC ruled, was to be paid by the farepayers.[245] The estimate of this item of cost was, as we have stated, in excess of $10 million.[246]

PUC's treatment of the latter item did not, however, go unchallenged. In *Bebchick* v. *Public Utilities Commission*,[247] consumers contended that the expense of track removal and street repaving was a burden which Transit's investors had assumed by the terms of the franchise[248] and so was not properly an operating cost. They asserted, in their words, that "it is unreasonable and unlawful to require the farepayers to make contributions of capital to Transit by the device of an allowance for track removal and repaving."[249] To buttress this point, they adverted to Transit's purchase of Capital's assets at more than $10

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[242] See Part IV(A), *supra*, at notes 201, 211-18.

[243] *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 155-60.

[244] *Id.* at 156-57.

[245] *Id.* at 155-56.

[246] See text *supra* at note 239.

[247] *Supra* note 185.

[248] See note 237, *supra*.

[249] 115 U.S.App.D.C. at 220, 318 F.2d at 191.

million less than their book value, and argued that that came about in consequence of Transit's assumed track removal and repaving obligation. The argument failed, however, and the point respecting track removal and repaving costs was lost, when this court concluded that the benefit of the reduced purchase price was being passed on to Transit's consumers.[250]

A full understanding of the basis of so much of our holding in *Bebchick* requires some elaboration of the technique PUC utilized in dealing with the $10 million difference between Capital's book value and Transit's purchase price of the acquired assets. The portion of the purchase price assignable to road and equipment, including the parcels of realty under scrutiny now,[251] was $10,339,041 less than the depreciated original cost of assets in those categories as carried on Transit's books.[252] As we were later to explain,

> Transit's allowances for depreciation thereon could, of course, have been related to its own acquisition costs; but this would have required the development of new depreciation rates computed on remaining life, and new depreciation bases derived in part from distribution of the purchase price among the items of property acquired. To save the labor incidental to that process, however, [PUC] . . . ordered that two things be done. One was the establishment of [an] acquisition adjustment account to accommodate an amortization, over a ten-year period beginning August 15, 1956, of the $10,339,041 difference in acquisition costs to Capital and Transit, respectively.

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[250] *Id.* at 221, 318 F.2d at 192.

[251] See *D.C. Transit Sys., Inc.* (Order No. 3592), at 5, exh. 2 (D.C. Pub. Utils. Comm'n Nov. 27, 1957) (unreported).

[252] *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 155.

> The other was a direction that depreciation be accrued on the basis of Capital's original cost and at the rates previously fixed for Capital, with ten annual offsetting credits to operating expenses of $1,033,904 derived from the amortization.[253]

The objectives of this accounting arrangement thus appear sharply. With the addition to Transit's purchase price of annual offsetting credits to operating expenses, Transit's investors would ultimately pay Capital's book value of road and equipment in full. And farepayers, in consequence of the offsetting credits, would ultimately contribute $10 million less to Transit's operational costs. The investors would, of course, benefit from depreciation at Capital's depreciation rates; theoretically, post-acquisition depreciation by this method would work out to the same amounts as if new depreciation bases had been established at Transit's acquisition costs. So, in *Bebchick*, after examining PUC's explanation of the foregoing,[254] we concluded that "[i]n this manner the Commission gave consideration to the reduced purchase price by Transit."[255] "The farepayers," we explained, "will receive benefit in the form of reduced depreciation in the total amount of $10,399,041 to be written off annually in the amount of $1,033,904."[256]

—*Accrual of Advantages*

As we have stated, the properties upon which our present inquiry focuses were all acquired by Transit from Capital in 1956. They came to Transit as a single pack-

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[253] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 367, 415 F.2d at 947.

[254] *Bebchick* v. *Public Utils. Comm'n*, *supra* note 185, 115 U.S.App.D.C. at 220-21, 318 F.2d at 191-92.

[255] *Id.* at 221, 318 F.2d at 192.

[256] *Id.*

age—all of the assets Capital then owned; Transit got the assets, not by buying them as such, but rather by buying all of Capital's outstanding capital stock.[257] And in the great majority of instances, the purchased real estate which is no longer devoted to public use was removed from service because of the conversion from a trolley-bus to an all-bus system of transportation. These were parcels on which were located carbarns, repair shops and other buildings used and useful when the streetcars were still running;[258] because these properties were unsuited to Transit's all-bus operation, the conversion rendered them surplus to Transit's needs. And, lest we forget, the financial burden of the conversion was, in its entirety, placed upon those who rode Transit's vehicles.[259]

From the foregoing discussion, the realities of the situation become plain enough. Transit got from Capital an on-going transportation system, including improved land, which the latter had acquired years before on obviously lower real estate markets. The price Transit paid Capital was calculated, not on fair market value of the acquired assets, but on a fixed per-share valuation of Capital's stock, which worked out to much less than even the value of the assets as depreciated on Capital's books.[260] We know that the price of Capital's road and equipment was some $10 million less than book value,[261] and we cannot approximate how much less than fair market value at the time of acquisition the total price for all

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[257] *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 155-60.

[258] See appendix.

[259] See text *supra* at notes 242-56.

[260] *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 158.

[261] See text *supra* at notes 233-34.

assets may have been.[262] There is nothing to justify an assumption that the price allocable to the parcels of realty here involved was anywhere near their true market value.[263]

In addition to what ostensibly was an acquisition of the properties at an excellent bargain,[264] Transit secured other valuable advantages—all at the expense of its traveling public. Within four years after commencing operations, Transit, largely as a result of legislative policy declared in its franchise,[265] began obtaining fare increases on the basis of its gross operating revenues rather than on the

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[262] The original cost of Capital's road and equipment alone was $49,818,718. *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 162. The remaining assets purchased, amounting to $8,592,952.54, consisted in cash and miscellaneous items. *D.C. Transit Sys., Inc.* (Order No. 3592), *supra* note 251, at exh. 2.

[263] It was for this reason that PUC, in establishing Transit's rate base prior to shifting to the operating ratio method, see note 266, *infra*, refused to accept the price which Transit paid to Capital as a true reflection of the fair value of the assets acquired. *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 155.

[264] PUC's utilization of the acquistion adjustment account, see text *supra* at notes 251-56, in no way qualifies this characterization. The acquisition adjustment device raised the investors' cost-of-purchase from $13.5 million to $23.8 million, but the $23.8 million was Capital's book value, not the fair market value, of the assets acquired. Original cost of those assets exceeded $58 million, see note 262, *supra*. The land included among those assets, acquired much earlier on obviously much lower markets, surely had a market value at Transit's acquisition which was greatly higher than Capital's book value based on original cost. See text *supra* at notes 260-62 and note 262, *supra*.

[265] See Franchise Act, tit. I, pt. I, § 4, 70 Stat. 598 (1956).

system rate base which had been employed for Capital.[266] Thus Transit could carry on its transportation business with a minimum of invested capital, and that it has done as long as it has been a public utility.[267] With the franchise-conferred monopoly[268] of the lion's share of mass transportation in the Washington metropolitan area,[269] Transit

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[266] When Transit succeeded Capital, the latter's rates were set on a rate base established on original cost. See *Speigel* v. *Public Utils. Comm'n*, 145 F.Supp. 679, 680 (D.D.C. 1956), *aff'd*, 101 U.S.App.D.C. 93, 94-95, 247 F.2d 84, 85-86 (1957). In Transit's first fare proceeding, PUC declined to switch to the operating ratio method, *D.C. Transit Sys., Inc.* (Order No. 4480), 25 P.U.R.3d 371, 374 (1958); instead, it fixed the rate base at $14,167,375 by giving equal weight to Capital's depreciated original cost and Transit's purchase price. *Id.* at 374-76. See also *D.C. Transit Sys., Inc.* (Order No. 4631), *supra* note 164, 33 P.U.R.3d at 163-64. In 1960, however, PUC permitted the shift to operating ratio, with the rate-base rate of return method as a check on reasonableness of the return. *Id.* at 144-48. See also *D.C. Transit Sys., Inc.* (Order No. 4735), *supra* note 164, 38 P.U.R.3d at 25-26. We approved the shift in *Bebchick* v. *Public Utils. Comm'n*, *supra* note 185, 11[illegible] U.S.App.D.C. at 219-20, 318 F.2d at 190-91.

On the advantage a transit company derives from use of the operating ratio method rather than a system rate base, see 1 A. Priest, Principles of Public Utility Regulation 221-24 (1969); Wright, *Operating Ratio—A Regulatory Tool*, 51 Pub. Util. Fort. 24-29 (1953).

[267] See S. Rep. No. 91-760, 91st Cong., 2d Sess. 3 (1970); *D.C. Transit Sys., Inc.* (Order No. 1216) (WMATC May 19, 1972), at 9-10 (as yet unreported), quoted on affirmance in *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 171, —— U.S.App.D.C. at —— n.28, 466 F.2d at 398 n.28.

[268] Franchise Act, tit. I, pt. 1, § 3, 70 Stat. 598 (1956).

[269] Transit was one of four utilities operating regular-route transportation systems in the area. One of the other

was enabled not only to function with a capital outlay of but $500,000 plus reinvested gains and earnings from operations,[270] but also to distribute $4,390,000 in dividends —an actual paid-out return of 830 percent on original equity—during the first decade of its existence.[271]

To the foregoing circumstances must be added others—hardly less important, and equally contributors to a potential windfall. After Transit's acquisition from Capital, the properties now questioned remained in operating status for various periods, and indeed two apparently always so remained.[272] In that status they have possessed incidents and immunities they could not summon below the line. They have commanded preferred real estate tax treatment.[273] They were, as above-the-line assets, a part of Transit's rate base during the years prior to adoption of the operating ratio method of establishing its margins of return.[274] Even under the latter method, in vogue since 1960,[275] the properties have counted

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three was a wholly-owned subsidiary of Transit, and the other two commanded but fragments of the transit market and operated almost exclusively in suburban areas.

[270] See sources cited *supra* note 267.

[271] S. Rep. No. 91-760, 91st Cong., 2d Sess. 3 (1970). And see *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 171.

[272] See appendix.

[273] See Franchise Act, tit. I, pt. 1, § 9(g), 70 Stat. 598, 601 (1956), prescribing a statutory formula which requires a Commission determination that Transit failed to earn a 6½% rate of return during the previous year. From 1961 to 1968, inclusive, real estate taxes from which Transit was exempted totaled $1,381,177. S.Rep. No. 91-760, 91st Cong., 2d Sess. 3 (1970).

[274] See note 266, *supra*.

[275] See note 266, *supra*.

in the computation of Transit's equity, a factor in turn influencing Transit's rate of return from transportation operations.[276] And they have continued to appreciate in value on the steadily rising local real estate market, which unhesitatingly we notice judicially, while enjoying these advantages as operating properties.

Surely the greatest advantage to Transit's investors—and one more specifically referable to the problem at hand—was derived from the scrapping of Capital's street railways in favor of a motorized transportation system. The changeover, as we have said, was mandated by Transit's franchise,[277] and the treatment accorded the changeover program worked strongly in Transit's favor. Assessment of the incidental loss of more than $5 million on Transit's riders[278] resulted in rapid recoupment of investors' equity in the abandoned rail facilities by amortization through Transit's fareboxes. The expense of track removal and repaving to date—some $10 million more—was likewise assessed against the farepayers.[279] Thus the conversion to Transit's all-bus operation has been speedily accomplished, and wholly without expense to Transit. And the crowning consideration is the incontrovertible fact that the conversion, at full cost to the farepayers, was the *sine qua non* to release of valuable real properties from operating roles in the transportation scheme for uses in non-transportation ventures.[280]

Both the Commission and this court have recognized the efficacy of this relationship of Transit's large-scale

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[276] See note 266, *supra*.

[277] See note 237, *supra*.

[278] See text *supra* at notes 243-50.

[279] See text *supra* at notes 245-50.

[280] See appendix.

retirement of real estate from operating status to the track removal and repaving program and the financial burdens it imposed on Transit's farepayers. In 1959, when in *D.C. Transit System, Inc.* (Order No. 4577) [281] Transit's sale of its Fourth Street Shops and Southern Carhouse [282] was examined, and a decision was made as to the allocation between Transit's consumers and its investors of the net profits attributable to the physical improvements on those properties, PUC declared:

> In light of the franchise of the company requiring a gradual program of conversion from railway to bus operations over a 7-year period from January 24, 1956, we are unable to dissassociate the instant transaction from the imminent retirement of all rail property under the mandate contained in the franchise. We cannot ignore the probability that full provision for depreciation will not have been provided when the rail facilities are abandoned and retired by reason of conversion. The company has consistently taken the position that any retirement loss in this connection should be recovered by charges against the customers, and the staff has heretofor indicated its agreement.[283] However, if the customers are to be required to bear the burden of extraordinary retirement losses incident to the whole conversion program, it appears equitable that they should share, at least to some extent, in extraordinary retirement gains of the nature here under consideration.[284]

The extent of the sharing, PUC made clear, was to be ascertained by "a fair balance between the interests of

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[281] *Supra* note 33.

[282] See Part II(A), *supra* at notes 33-55. See also *Bebchick* v. *Public Utils. Comm'n, supra* note 185, 115 U.S.App. D.C. at 219-23, 318 F.2d at 190-94.

[283] This position later gained full administrative and judicial acceptance. See text *supra* at notes 243-56.

[284] 30 P.U.R.3d at 412.

the public and those of the company's investors;"[285] and on judicial review of Order No. 4577, we affirmed.[286]

Six years later, in *D. C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission*,[287] this court sitting *en banc*, was called upon to scrutinize the transaction in a different context. An objection to allowance of a depreciation charge for abandoned rail facilities was predicated in part on the claim that the sales were occasioned by the conversion program, and that, in consequence, the profits realized should be deemed a recoupment of obsolescence.[288] Transit asserted, *inter alia*, that the sales were unrelated to the program, and although we acknowledged "some force to Transit's contention,"[289] we neither reexamined nor disapproved the Commission's resolution on that score.[290] But our opinion made manifest our view that if, as the Commission thought, there was a connection between the sales and the conversion program, farepayers' sharing in the proceeds was consonant with the equities of the situation.[291]

This became the plainer when we moved to a consideration of a second transaction urged in support of disallowance of the depreciation charge.[292] That transaction was Transit's sale of its Georgia and Eastern

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[285] *Id.*

[286] *D.C. Transit Sys., Inc.* v. *Public Utils. Comm'n, supra* note 51.

[287] *Supra* note 18.

[288] *Id.* at 396-97, 350 F.2d at 773-74.

[289] *Id.* at 397, 350 F.2d at 775.

[290] See *id.*

[291] See *id.*

[292] See *id.* at 397-98, 350 F.2d at 775-76.

Terminal in 1962, in which it allegedly reaped a substantial profit on the depreciable portion of the realty.[293] The parties had made no effort to establish the reasons for the sale, apparently because it had occurred after the close of the audit period on which the Commission's projections were based.[294] Transit argued, however, that the only evidence of record demonstrated the disassociation of the sale and the conversion program, basing that position on testimony that before the sale the terminal "was used for bus operations *also*." [295] We pointed out that that testimony "suggests that it may have been used in Transit's rail operations as well," [296] and that "it may or may not be true that the sale was in some way related to Transit's conversion to an all-bus system." [297] "If it was," we continued, "the Commission should address itself to the question, as did the PUC in the case of the Fourth Street Shops,[298] of whether the riders should be afforded some participation in the benefits of the sale." [299] And we admonished that "[f]ollowing our remand, . . . the Commission should determine whether the sale of the terminal was occasioned, in whole or in part, by the abandonment of rail operations, and, if it was, whether and to what extent the farepayers should share in the proceeds." [300]

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[293] But see Part II(A), *supra*, at notes 60-64.

[294] 121 U.S.App.D.C. at 397-98, 350 F.2d at 775-76.

[295] *Id.* at 398, 350 F.2d at 776 (emphasis in original).

[296] *Id.*

[297] *Id.*

[298] See Part II(A), *supra*, at notes 33-35.

[299] 121 U.S.App.D.C. at 398, 350 F.2d at 776.

[300] *Id.* On remand, *D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 18, the Commission found that the abandonment

It cannot be gainsaid, then, that several important propositions are firmly imbedded in our jurisprudence. Transit's investors cannot automatically garner the profits achieved on dispositions of depreciable real estate which in some way have been affected by the conversion program. Relevant inquiries are whether the disposition "was occasioned, in whole or in part, by" the conversion program[301] or "was in some way related to" it.[302] If so,

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of the terminal and its subsequent sale were unrelated to the conversion program. It said:

> A review of the transcript reveals that retirement of this property was not associated with the retirement of rail property. While the rail system was in use, the Georgia and Eastern Terminal served in a dual capacity, both as a terminal for rail service and for bus service. After the rail system was phased out, the terminal was used exclusively in bus operations. Sometime thereafter, due to the request of riders to move the terminal further north, the company relocated its terminal in Silver Spring and discontinued the terminal facilities at the Georgia and Eastern location. It is apparent to the commission that the termination of this facility as property used and useful in the transit business was predicated solely on the realignment of its bus terminal facilities and its removal from service was completely disassociated with the termination of the rail operation. Thus, it is our determination that the sale of the terminal was occasioned neither in whole nor part by the abandonment of rail operations. Therefore, the ratepayer is not entitled to share in any portion of the proceeds of that sale, unless there was a profit on the depreciable portion of the asset sold. There was none in this case.

Id. at 33-34. In this aspect, Order No. 563 was not brought under judicial review.

[301] See text *supra* at note 300.

[302] See text *supra* at note 299.

Transit's farepayers are entitled to a fair share of such profits. The extent to which they are to share depends upon "a fair balance between the interests of the public and those of the company's investors." [303]

—The Commission's Claimed Accounting Practice

We are advertent to the consideration that the propositions just discussed have developed in litigation directly referable to allocations of profits gained on disposition of depreciable utility assets. We think, however, that no difference in principle can be justified solely on the ground that the asset in question, or some part thereof, happens to be nondepreciable. Both PUC and the Commission have made such a distinction on the stated theory that capital gains from nondepreciable property invariably belong to investors.[304] Counsel for the Commission contends additionally that we should defer to a uniform accounting rule to that effect which the Commission is said to have pursued. For two reasons, we reject these positions.

In the first place, neither the Commission nor its counsel has pointed to any agency-promulgated accounting rule operative as to the value-appreciations on the lands in question. The Compact empowered the Commission to prescribe uniform systems of accounts for carriers functioning under its jurisdiction, but required that its authority to do so be exercised "by regulation." [305] No

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[303] See text *supra* at note 285.

[304] See Part III(B), *supra*, at notes 96-111.

[305] "Each carrier subject to the Commission shall keep such accounts, records, and memoranda with respect to activities in which it is engaged . . . as the Commission *by regulation* prescribes. The Commission shall *by regulation* prescribe the form of such accounts, records, and memo-

such regulation of the Commission or its predecessor agency relevant to the problem at hand has ever been identified either in the Commission's opinions or its counsel's argument.[306] The opinions contain only the gratuitous pronouncements on the subject to which we have alluded,[307] and the argument is similarly unrevealing.

In 1966, the Commission did adopt an accounting regulation dealing with allocations of value-appreciations of depreciable properties.[308] Since then, the Commission has made explicit reference to that regulation in its decision-making and in its argument here.[309] It is difficult to believe that if indeed the Commission had a counterpart applicable to the nondepreciable properties under scrutiny, it would leave us in the dark about it. We may assume that, as a matter of unwritten policy, the Commission has indulged accounting techniques conformable with its

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randa, and the length of time that such accounts, records and memoranda shall be preserved." Compact, *supra* note 12, tit. II, art. XII § 10(b) (emphasis supplied).

[306] While "[a]ll rules, regulations, orders" and "decisions" of PUC, and "[a]ll" "other action prescribed" by it, survived the Commission's succession until changed, *id.* § 21, there is no showing that PUC ever acted formally on the matter under discussion or that, if it did the Commission ever rested its own action thereon.

[307] See text *supra* at notes 89-111.

[308] Regulation 61, which we discuss in No. 23,720, *Bebchick* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 3, and No. 24,398, *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 3, in connection with issues raised in those cases. That regulation, treating as it does gains on depreciable assets, has no direct applicability to the issue involved in the instant case.

[309] See *D.C. Transit Sys., Inc.* (Order No. 1090), *supra* note 64, 85 P.U.R.3d at 513-14.

mistaken notion of a settled principle on the subject,[310] but that is a far cry from the deliberate, reasoned rulemaking which the Compact obviously contemplates.[311] In sum, neither PUC nor the Commission has ever spoken of an extant accounting regulation treating gains on the nondepreciable assets in issue, and it is well settled that counsel's own *post hoc* rationalizations are not an acceptable substitute.[312]

Moreover, even if we could agree that the Commission, by virtue of its brief comments in Orders Nos. 245 and 563 and those of PUC in Order No. 4577,[313] had ordained that on Transit's books the appreciation on in-service nondepreciable assets should be credited to investors, the mere adoption of such an accounting practice would not terminate our inquiry. Accounting procedures are not self-justifying; like other regulatory action of the Commission, they must reflect a rational allocation of economic rights and responsibilities between a utility's investors and consumers.[314] The simple fact that an agency treats an item a certain way for purposes of its uniform system of accounts does not mark the end of judicial scrutiny; on the contrary, a reviewing court must assure itself that the accounting practice prescribed is consistent with under-

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[310] See text *supra* at note 107.

[311] See note 305, *supra*.

[312] *E.g., Burlington Truck Lines* v. *United States*, 371 U.S. 156, 168-69 (1962); *SEC* v. *Chenery Corp.*, 318 U.S. 80, 92-95 (1942); *Local 833, UAW* v. *NLRB*, 112 U.S.App.D.C. 107, 112-13, 300 F.2d 699, 704-05, *cert. denied*, 370 U.S. 911 (1962).

[313] See text *supra* at notes 60-64, 96-111.

[314] See *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 350, 358-59 & n.86, 415 F.2d at 930, 938-39 & n.86.

lying substantive principles of public utility law.[315] To permit an accounting device to dictate the rule of law is to allow the tail to wag the dog. To judicially accept an accounting method without inquiry as to its reasonableness is to pervert the law. And to yield, on judicial review, unquestioning obeisance to administrative authority over utility accounting is to abdicate the responsibility to review.

In the final analysis, administrative regulation by prescription of accounting methods stands on no higher ground than regulation by adjudication where substantial interests of investors and consumers are at stake. Accounting directives, no less than other exertions of administrative power, must survive the test of rationality.[316]

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[315] See *In re Republic Light, Heat & Power Co.*, 265 App. Div. 53, 37 N.Y.S.2d 947, 949 (Sup.Ct.App.Div. 1942); *New York Edison Co.* v. *Maltbie*, 244 App.Div. 685, 281 N.Y.S. 223, 226 (Sup.Ct.App.Div. 1935), *aff'd*, 271 N.Y. 103, 2 N.E. 2d 277, 279 (1936).

[316] Legislative grants of administrative authority over public utility accounting are designed to meet the informational needs of effective regulation and the public needs of economical rates, particularly as either may be affected by inflationary write-ups or expense padding. *American Tel. & Tel. Co.* v. *United States*, 299 U.S. 232, 237, 239, 240, 246 (1936); *Norfolk & W. Ry.* v. *United States*, 287 U.S. 134, 140 (1932); *Kansas City S. Ry.* v. *United States*, *supra* note 198, 231 U.S. at 440, 449; *ICC* v. *Goodrich Transit Co.*, 224 U.S. 194, 211, 216 (1912). Compare *United States* v. *New York Tel. Co.*, 326 U.S. 638 (1946); *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944). Supervision of accounting, of course, is due the same respect accorded other administrative action, and "in gauging rationality, regard must steadily be had to the ends that a uniform system of accounts is intended to promote." *American Tel. & Tel. Co.* v. *United States*, *supra*, 299 U.S. at 237. Deference to an agency's

And the validity of the administrative exercise must be judged solely on the grounds upon which the agency based it.[317] Our examination of the grounds which the Commis-

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treatment of accounting problems reaches its zenith where the issue is one of pure accounting, notwithstanding incidental intrusion upon management prerogatives, see *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 474-76 (1950); *United States* v. *New York Tel. Co.*, *supra*, 326 U.S. at 654-55; *Northwestern Elec. Co.* v. *FPC*, *supra*, 321 U.S. at 123-24; *American Tel. & Tel. Co.* v. *United States*, *supra*, 299 U.S. at 236-37; *Norfolk & W. Ry.* v. *United States*, *supra*, 287 U.S. at 141-43; *Kansas City S. Ry.* v. *United States*, *supra*, 231 U.S. at 441, 444, but even those features of agency action may be judicially examined for arbitrariness. *Northwestern Elec. Co.* v. *FPC*, *supra*, 321 U.S. at 124; *American Tel. & Tel. Co.* v. *United States*, *supra*, 299 U.S. at 236-37; *Norfolk & W. Ry.* v. *United States*, *supra*, 287 U.S. at 143; *Arkansas Power & Light Co.* v. *FPC*, 87 U.S.App.D.C. 385, 387, 185 F.2d 751, 753 (1950), *cert. denied*, 341 U.S. 909 (1951). See also *Kansas City S. Ry.* v. *United States*, *supra* note 198, 231 U.S. at 452-53, 456-57. *A fortiori*, judicial responsibility is as grave where the accounting issue draws in substantive relationships of utility and consumers. As this court has specifically held, accounting actions of the very type involved here—those which in effect regulate allocations of value-appreciations achieved on operating utility assets—may be freely reviewed to enable decision of "questions of law" and determination as to whether the basis for action is "unreasonable, arbitrary, or capricious." *D.C. Transit Sys., Inc.* v. *Public Utils. Comm'n*, *supra* note 51, 110 U.S.App.D.C. at 242, 292 F.2d at 735.

[317] *SEC* v. *Chenery Corp.*, *supra* note 312, 318 U.S. at 87; *Bond* v. *Vance*, 117 U.S.App.D.C. 203, 204, 327 F.2d 901, 902 (1964); *Local 833, UAW* v. *NLRB*, *supra* note 312, 112 U.S.App.D.C. at 113, 300 F.2d at 705; *NLRB* v. *Capital Transit Co.*, 95 U.S.App.D.C. 310, 313, 221 F.2d 864, 867 (1955); *Democrat Printing Co.* v. *FCC*, 91 U.S.App.D.C. 72, 77-78, 202 F.2d 298, 302-03 (1952); *Mississippi River Fuel Corp.* v. *FPC*, 82 U.S.App.D.C. 208, 224, 163 F.2d 433, 449 (1947).

sion, when it acted, proffered in support of the accounting practice under scrutiny has left us wholly unsatisfied as to its rationality. We have adverted to the two premises upon which the Commission has rested its distinctive treatment of gains on nondepreciable property.[318] We have also noted that by our appraisal those premises are fatally defective.[319] It necessarily follows that we must now reject the claim that the Commission has effectively decreed the disposition of value-appreciations on nondepreciable utility assets by an appropriate exercise of its authority over utility accounting.

—The Balance Here

The allocation between investors and consumers of capital gains on in-service utility assets, we have declared, rests essentially on equitable considerations.[320] The allocative process, we have said, necessitates a delicate balancing of the interests of investors and consumers in light of the governing equitable principles.[321] The constant effort must be a distribution of the gains as fairness and justice may require. In particular instances, however, the direction in which the equities lie is so vividly marked by the circumstances of the case that the allocation properly to be made emerges plainly. We think such an instance is presented here.

The relevant principles can be stated simply. Consumers become entitled to capital gains on operating utility assets when they have discharged the burden of preserving the financial integrity of the stake which investors have in such assets.[322] Their entitlement is estab-

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[318] See text *supra* at notes 107-11.

[319] See text *supra* at notes 110-11.

[320] See text *supra* at Part IV(A).

[321] See text *supra* at note 177.

[322] See Part IV(A), *supra*, at notes 181-227.

lished, too, when it is manifest that investors have benefitted measurably from special treatment accorded those assets in the past.[323] And in appraising the equities, neither administrative nor judicial tribunals are at liberty to ignore economic reality. The stark reality here is that Transit's farepayers have long been saddled with the burdens incidental to the properties in issue while they remained in operating status. Theirs were the expenses of ordinary maintenance[324] and depreciation,[325] and the risks of loss from casualty[326] and obsolescence,[327] associated with those properties. These they shouldered over the years not only for Transit but also for Capital, Transit's predecessor. Theirs also were the losses wrought by the conversion program, which directly made transfers of some assets, nondepreciable as well as depreciable, from above to below the line possible.[328] And Transit's investors have profited, not only from these arrangements of burdens, but also from favorable treatment of the operating assets in other ways.[329] By our assessment, these circumstances tip the scale in favor of Transit's farepayers, so much so as to earn for them the gains beyond the shadow of a doubt.

This court has never adopted the Commission's position that capital gains on nondepreciable assets inure to investors only.[330] We decline to adopt that position now.

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[323] See Part IV(A), *supra*, at notes 272-82.

[324] See Part IV(A), *supra*, at notes 219-20.

[325] See Part IV(A), *supra*, at notes 197-218.

[326] See Part IV(A), *supra*, at note 186.

[327] See Part IV(A), *supra*, at note 201.

[328] See Part IV(B), *supra*, at notes 243-46.

[329] See Part IV(A), *supra*, at notes 272-82.

[330] See Part II(B), *supra*, at notes 96-111. As we there point out, the Commission's several pronouncements on that score have never been subjected to judicial review.

Our historical analysis of the interests of investors in value-appreciations of operating utility assets demonstrates beyond a doubt that the burden of safeguarding the utility's investment in all of its assets—depreciable and nondepreciable—is legally assigned in its entirety to consumers.[331] As we have further pointed out, even were the risk on the lands involved here theoretically one which had been carried by the investors, that risk becomes mythical when viewed in light of the high unlikelihood that the value of the lands would decline.[332] Furthermore, measuring the equities of the situation by relevant doctrinal considerations, it is plain that Transit's busriders have shouldered a very significant financial onus with respect to those lands, and that Transit's investors have benefitted uniquely in their ownership of them,[333] and that a reasonable and fair allocation of their appreciation in market value accords that gain to the farepayers.[334] Unlike situations wherein the basis for profit-sharing by farepayers may consist solely in the loss-risk factors associated with depreciable property[335] and the burden of contributions to depreciation reserves[336]—considerations largely or entirely absent in instances of nondepreciable property—farepayers' equities founded upon their assumption of the remaining economic responsibilities[337]— including those occasioned by a costly conversion program[338]—and upon investors' enjoyment of

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[331] See Part III, *supra*.

[332] See text *supra* at notes 228-29.

[333] See text *supra* at notes 264-76.

[334] See Part IV(B), *supra*.

[335] See Part III(A), *supra*.

[336] See Part III(A), *supra*.

[337] See text *supra* at notes 257-76.

[338] See text *supra* at notes 277-300.

especially-conferred advantages not generally available to others,[339] are precisely the same whether the source of the gain is depreciable or nondepreciable property. We hold that a farepayers' claim so predicated must be recognized and effectuated whether the property be of the one character or the other.

With respect to the properties not directly related to Transit's conversion to an all-bus transportation system, the equities also weigh in the riders' favor. Transit acquired all of its landholdings at a tremendous bargain when it assumed Capital's franchise,[340] and enjoyed valuable special benefits for them in the years which followed.[341] In none of these benefits did the farepayers share, although they had been charged with major economic responsibilities stemming from Transit's takeover of its predecessor's operations.[342] Given these circumstances, we would be loath to say that the riders are not equitably entitled to the value appreciations on these properties as well. We hold that the farepayers were entitled to all appreciations in the value of the assets in issue, depreciable and nondepreciable,[343] accruing during their tenure as operating properties.

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[339] See text *supra* at notes 264-76.

[340] See text *supra* at notes 260-64.

[341] See text *supra* at notes 265-76.

[342] See text *supra* at notes 237-50.

[343] In referring to the amount of appreciation or gain on the assets while in service, we are speaking of a net figure. The amount which should be credited to the farepayers is not the entire difference between book value and market value of the assets at the time of transfer, but rather that sum minus the taxes and sale expenses which would have been deducted from Transit's profit if the assets had been sold outright instead of simply being moved into nonoperating status.

We also reject the contention that the right of the fare-

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DISPOSITION

The foregoing considerations lead us to the conclusion that Order No. 773 is invalid and must be set aside.[344] Thus we reach, as the final chapter of this review, the disposition required by the circumstances that the fares fixed by that order have been charged and paid since it went into effect. To this matter we now proceed.

A. *Responsibility For Fashioning Relief*

The initial question is whether the fashioning of relief from the predicament we face lies properly within the judicial sphere or, instead, the administrative. It is clear to us beyond peradventure that this court and the Commission should share the burden in this case.

A judicial determination that a Commission fare order was invalid has normally called for remediation in a dual aspect. First because the invalid order could not be indulged continued operation, a resetting of fares was

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payers to gains in the value of these properties does not ripen until the properties are sold. Our reasons for holding that the right accrues at the time the assets are removed from operating status are discussed more fully in *Bebchick* v. *Washington Metropolitan Area Transit Comm'n, supra* note 2, at 31-33 and in *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 3, at 29-30. It suffices here to point out that the Commission's own Regulation 61 crediting value-appreciations on depreciable assets to the farepayers specifies this practice, and we see no reason for treating nondepreciable assets differently. See *Bebchick* v. *Washington Metropolitan Area Transit Comm'n, supra* note 2, at 32-33.

[344] Compare *Williams* v. *Washington Metropolitan Area Transit Comm'n, supra* note 16, 134 U.S.App.D.C. at 358-59, 415 F.2d at 938-39.

ordinarily needed for the future.[345] When there was such a need, it is evident that it had to be met by the Commission. We possess no ratemaking powers as such; our authority is confined within the traditional bounds of judicial review. "Our function" in relation to pure ratemaking "is normally exhausted when we have determined that the Commission has respected procedural requirements, has made findings based on substantial evidence, and has applied the correct legal standards to its substantive deliberations."[346] "Our task," we have said, "is likewise at an end when we have ascertained that the Commission has not done so."[347] On the other hand, "even where agency action must be set aside as invalid, but the agency is still legally free to pursue a valid course of action,"[348]—not the present situation[349]—"a reviewing court will ordinarily remand to enable the agency to enter a new order after remedying the defects that vitiated the original action."[350]

The second, but quite different, aspect of the relief required where a court has declared a Commission fare order to be invalid, is remediation of the consequences wrought by the order while it was actually operative. This is a problem which can neither be addressed nor solved by another order merely purporting to fix rates. "The Commission," we have declared, "possesses no au-

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[345] That is not invariably the situation, however. See text *infra* at notes 354-55.

[346] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 362, 415 F.2d at 942 (footnote omitted).

[347] *Id.* at 362-63, 415 F.2d at 942-43 (footnote omitted).

[348] *Id.* at 359, 415 F.2d at 939.

[349] See text *infra* at notes 390-403.

[350] *Id.* at 359-60, 415 F.2d at 939-40 (footnote omitted).

thority to fix rates for the past."[351] As we have pointed out, "[a]n order prescribing the lawful fares to be charged by a public utility, being essentially legislative in character, ordinarily speaks only for the future."[352] We have heretofore admonished that "we find nothing in the statutory provisions governing the Commission's regulatory responsibilities that indicates an intent to depart from [the] 'customary pattern of fixing rates prospectively.'"[353] Moreover, Order No. 773 has been superseded by later fare orders[354] and, because Transit's transportation operations have since Order No. 773 been publicly assumed, there is no possibility of any additional ratemaking by the Commission.[355] Rectification of the illegal consequences of an unlawful rate order must then consist in something other than retroactive ratemaking.[356]

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[351] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 360, 415 F.2d at 940.

[352] *Id.* (footnote omitted).

[353] *Id.* at 360-61, 415 F.2d at 940-41 quoting *Transcontinental & Western Air, Inc.* v. *CAB*, 336 U.S. 601, 605 (1949) (footnotes omitted).

[354] See *D.C. Transit Sys., Inc.* (Order No. 882) (WMATC Oct. 29, 1968) (unreported); *D.C. Transit Sys., Inc.* (Order No. 984), *supra* note 165; *D.C. Transit Sys., Inc.* (Order No. 1052), 85 P.U.R.3d 1 (WMATC 1970). There is thus in this case the identical problem we encountered in *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 360, 415 F.2d at 940.

[355] See text *infra* at notes 390-403.

[356] Compare *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 360-61, 415 F.2d at 940-41. See also *Bebchick* v. *Public Utils.*

B. *The Restitutional Remedy*

The remedy, rather, is restitution. That was made plain by the decision of this court *en banc* in *Williams* v. *Washington Metropolitan Area Transit Commission.*[357] There we found that two orders of the Commission fixing fares for Transit were invalid, and that remand to the Commission for reconsideration of those orders would be futile.[358] "[I]t follows," we held, "that Transit must be compelled to make appropriate restitution for the increased fares it collected" under those orders.[359] We drew support for that conclusion from the "'principle, long established and of general application, that a party against whom an erroneous judgment or decree has been carried into effect is entitled, in the event of a reversal, to be

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Comm'n, supra note 185, 115 U.S.App.D.C. at 232-33, 318 F.2d at 203-04; *Washington Gas Light Co.* v. *Baker,* 90 U.S. App.D.C. 98, 104-05, 195 F.2d 29, 35 (1951). And see *Wisconsin* v. *FPC,* 373 U.S. 294, 304-06 (1963).

[357] *Supra* note 16.

[358] *Williams* v. *Washington Metropolitan Area Transit Comm'n, supra* note 16, 134 U.S.App.D.C. at 359-61, 415 F.2d at 939-41. There, as here, in addition to the obstacle of retroactive ratemaking, the orders under review had been superseded by subsequent fare orders. *Id.* at 360, 415 F.2d at 940.

[359] *Id.* at 362, 415 F.2d at 942 (footnote omitted). We added:

> This conclusion is unaffected by the fact that we do not decide that the fares authorized are unjust or unreasonable as a matter of law. Our role as a reviewing court is not to make an independent determination as to whether fares fixed by the Commission are just and reasonable, but rather to insure that the Commission in exercising its rate-making power, has acted rationally and lawfully.

Id.

restored by his adversary to that which he has lost thereby.'" [360] "This principle," we explained, "is no less applicable to erroneous orders of an administrative agency than to those of a court." [361] Here, no less than in *Williams*, "given our conclusion" that in formulating Order No. 773 "the Commission failed to apply appropriate criteria, and failed to make the inquiries prerequisite to valid exercise of its ratesetting authority, we could not permit Transit to retain the increased fares, since to do so would be to give legal effect to the Commission's invalid order." [362]

Thus the division of labor to which we have adverted [363] becomes apparent. While promulgation of fares is admini-

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[360] *Id.* at 362 n.97, 415 F.2d at 942 n.97, quoting *Arkadelphia Milling Co.* v. *St. Louis S. W. Ry.*, 249 U.S. 134, 145 (1919). See also *Baltimore & O. R.R.* v. *United States*, 279 U.S. 781, 785-86 (1929); *Atlantic Coast Line R.R.* v. *Florida*, 295 U.S. 301, 309 (1935).

[361] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 362 n.97, 415 F.2d at 942 n.97. This was well established long prior to *Williams*. See *United Gas Pipe Line Co.* v. *Mobile Gas Co.*, 350 U.S. 332, 347 (1956); *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 340, 295 U.S. at 309-11; *Bebchick* v. *Public Utils. Comm'n*, *supra* note 185, 115 U.S.App.D.C. at 218-19, 232-33, 318 F.2d at 189-90, 203-04; *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 127, 188 F.2d at 23.

[362] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 363, 415 F.2d at 943 (footnote omitted). As we added there, "[t]his is so notwithstanding that we have held neither that the Commission lacked power to order a fare increase, nor even that the fares authorized are, as a matter of law, unjust or unreasonable." *Id.* (footnote omitted). See also note 359, *supra*.

[363] See text *supra* at notes 345-56.

strative business,[364] the fashioning of restitutional remedies is a judicial function.[365] We are thus brought to a consideration of the criteria by application of which the amount of restitution in this case must ultimately be determined.

Restitution is essentially an equitable remedy.[366] As we said in *Williams*, "our decision in this regard is to be governed by the equitable considerations which apply to suits for restitution generally."[367] So, "[t]he basic question" in quests for restitution "is whether 'the money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it' and is 'no longer whether the law would put him in possession of the money if the transaction were a new one.' "[368] To be sure, "[o]rdinarily . . . the proper disposition on setting aside a rate increase unlawfully ordered by the Commission would be to compel the regulated company to restore the entire difference between the higher fares collected under the invalid order and the amount that it would have received from the fare schedule previously in effect."[369]

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[364] See text *supra* at notes 345-48.

[365] See cases cited *supra* note 361. This is not to say that the court cannot utilize the administrative expertise of the agency to assist the discharge of the judicial function. Indeed, we do so in this very case. See text *infra* at notes 377-87.

[366] *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 360, 295 U.S. at 309; Restatement of Restitution § 142, comment *a* at 568 (1937).

[367] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 364, 415 F.2d at 944 (footnote omitted).

[368] *Id.*, quoting *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 360, 295 U.S. at 310.

[369] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 364, 415 F.2d at 944 (footnote omitted).

and we have had previous occasion to do just that.[370] "[R]estitution," however, "is not a matter of right, but is '*ex gratia*, resting in the exercise of a sound discretion;' "[371] it "is granted to the extent and only to the extent that justice between the parties requires."[372] It accordingly "lies within our authority to direct restitution in an amount less than the whole sum of the increased fares collected under the invalid order, or to deny it altogether, if compelling equitable considerations so dictate."[373]

We think the proper measure of restitution in this case lies somewhere between these two extremes. Here, as in *Williams*, "we have found the Commisison's action in approving the fare increase to have been invalid, and . . . we

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[370] See *Bebchick* v. *Public Utils. Comm'n*, *supra* note 185, 115 U.S.App.D.C. at 232-33, 318 F.2d at 203-04; *Washington Gas Light Co.* v. *Baker*, *supra* note 128, 88 U.S.App.D.C. at 127, 188 F.2d at 23.

[371] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 364, 415 F.2d at 944 (footnote omitted), quoting *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 360, 295 U.S. at 310.

[372] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. 364 n.106, 415 F.2d at 944 n.106, quoting Restatement of Restitution ch. 8 at 596 (1937).

[373] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 364, 415 F.2d at 944 (footnote omitted). As we put it there, "[t]he exercise of such an equitable discretion by this court is by no means an usurpation of the administrative powers of the Commission nor is it an arbitrary extension of judicial authority; it is 'mere inaction and passivity in line with the historic attitude of courts of equity for centuries.' " *Id.*, quoting *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 360, 295 U.S. at 315.

have no basis in later valid action of the Commission for inferring that the rates set by [that order] were in fact, just and reasonable. . . ." [374] Here, no more than there, do we find warrant to "give legal effect to those rates by withholding restitution altogether." [375] At the same time, as in *Williams*, "we see no obstacle to our permitting the Company to retain some, though not all, of the proceeds of a fare increase if there is reliable evidence suggesting that it would be inequitable to compel restitution in a greater amount." [376]

C. *The Commission's Role*

As already indicated, the restitutional task at hand, as a judicial function,[377] has become the responsibility of this court.[378] We inherit that responsibility as an inseparable incident of our duty to review Commission action when it is properly challenged,[379] and to specify appropriate remediation when the action reviewed is found to be erroneous.[380]

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[374] *Id.*

[375] *Id.*

[376] *Id.* at 364 n.106, 415 F.2d at 944 n.106. "The right of a person to restitution from another because of a benefit received is terminated or diminished if, after the receipt of the benefit, circumstances have so changed that it would be inequitable to require the other to make full restitution." Restatement of Restitution § 142(1) (1937).

[377] See text *supra* at notes 357-65.

[378] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 361-66, 415 F.2d at 941-46.

[379] Compact, *supra* note 12, tit. II, art. XII, § 17.

[380] When our authority to review a Commission order is properly invoked, we have "exclusive jurisdiction to . . .

In discharging the obligation thus entrusted to us, we must draw upon the resources at our command.[381] As we observed in *Williams*, "[i]n laying down a standard by which to measure Transit's right to retain funds collected under the fare increase, we are aware that we are ill-equipped, even were we authorized to do so, to search the record and reach our independent conclusions as to what would have constituted reasonable fares for the period in question."[382] But "[n]evertheless, the duty to reach a just decision in this regard cannot be shirked, and our effort must be to find a solution which lies within our competence as a reviewing court, while at the same time responding in the fullest possible measure to the equitable considerations that must guide us."[383]

We believe that the best approach to adjustment, in the restitutional sense, of the competing interests of Transit's investors and farepayers in this litigation is a combined effort of the Commission and this court.[384] The administra-

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modify . . . such order." Compact, *supra* note 12, tit. II, art. XII § 17(a). And see *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 361-66, 415 F.2d at 941-46.

[381] See, *e.g.*, *In re Peterson*, 253 U.S. 300, 312-14 (1920). And when "the public interest is involved . . . equitable powers assume an even broader and more flexible character than when only a private controversy is at stake." *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 398 (1946).

[382] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 366, 415 F.2d at 946.

[383] *Id.*

[384] An available alternative is a reference to a master for aid in working out the amount and details of restitution. See *In re Peterson*, *supra* note 381, 253 U.S. at 312-14. See also *NLRB* v. *Arcade-Sunshine Co.*, 76 U.S.App.D.C. 312, 132

tive expertise of the Commisison is in any event a potentially valuable aid to solution of the restitutional problem, and is the more so in light of the Commission's familiarity with many of its facets. "Judicial and administrative agencies," we recall, "'are to be deemed collaborative instrumentalities of justice.'"[385] We are also reminded that "[c]ourts have frequently called upon administrative bodies . . . for assistance in connection with the issues falling within the area of administrative competence."[386] In recent years, we have had occasion to enlist the Commission's assistance in working out the elements of restitution made necessary by another order invalidly raising Transit's fares.[387] In the case at bar, we do so once again, and we

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F.2d 8 (1942); *NLRB* v. *Remington Rand, Inc.*, 130 F.2d 919, 924-25 (2d Cir. 1942). For reasons stated in text, we deem the assistance of the Commission preferable.

[385] *Bethlehem Steel Corp.* v. *Grace Line*, 135 U.S.App.D.C. 81, 93, 416 F.2d 1096, 1108 (1969), quoting *United States* v. *Morgan*, 313 U.S. 409, 422 (1941). See also *United States* v. *Ruzicka*, 329 U.S. 287, 295 (1946); *S. S. W., Inc.* v. *Air Transport Ass'n*, 89 U.S.App.D.C. 273, 280, 191 F.2d 658, 664 (1951), *cert. denied*, 343 U.S. 955 (1952).

[386] *Bethlehem Steel Corp.* v. *Grace Lines*, *supra* note 385, 135 U.S.App.D.C. at 93, 416 F.2d at 1108. There we directed a court to stay a pending controversy to permit its consideration by an administrative agency, the agency's determination to play an advisory role in the court's resolution of the controversy. *Id.* at 91-94, 416 F.2d at 1106-09. See also, *e.g.*, *Order of Ry. Conductors* v. *Pitney*, 326 U.S. 561, 567-68 (1946); *Atchison T. & S. F. Ry.* v. *Aircoach Transp. Ass'n*, 102 U.S.App.D.C. 355, 363-64, 253 F.2d 877, 885-86 (1958); *Capital Transit Co.* v. *Safeway Trails, Inc.*, 92 U.S.App.D.C. 20, 23, 201 F.2d 708, 711 (1953).

[387] *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 16, 134 U.S.App.D.C. at 361-66, 396-97, 415 F.2d 941-46, 976-77. See also *Washington Gas Light Co.* v. *Baker*, *supra* note 356, 90 U.S.App.D.C. at 104-05, 195 F.2d at 35.

take this opportunity to outline the techniques the Commission may utilize in providing that assistance.

First, the amount of restitution must be ascertained. This determination will require identification of all properties which Transit shifted from above to below the line prior to issuance of Order No. 773. Once identified the market value of the properties at the time of their transfer to nonoperating status will have to be established. The dollar amount of restitution can then be arrived at by subtracting the book value of the properties from the market value at the time of the transfer. This figure will represent the appreciation in value of the assets, which should have been credited to the riders when the fares prescribed by Order No. 773 were set.

It can be readily seen that this method of determining the amount of restitution will in no way reduce Transit's return during the period the order was in effect to a confiscatory level. As we have pointed out, the only vitiating defect in Order No. 773 was the Commission's failure to allocate to the riders the gain in value of the properties with which we are concerned;[388] in all other respects the fares set by that order must be accepted as just and reasonable. Thus, restitution of the gain to the riders has the automatic effect of reducing the fares collected during the operative period of Order No. 773 to the level of reasonable return to which Transit was entitled.

There remains only the problem of how the amount of restitution, once determined, is to be applied to benefit the farepaying public. As we have observed, regulatory agencies may only fix rates for the future.[389] Moreover, public takeover of Transit's franchise has occurred,[390] and,

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[388] See note 16, *supra*.

[389] See text *supra* at notes 351-56.

[390] See text *infra* at notes 394-403.

as a result the Commission will no longer be setting fares for Transit.[391] Thus the rate mechanism cannot be the instrumentality for channeling relief to the busriders, but there are many ways in which the sum owing in restitution could be utilized profitably for the bus-riding public. The choice will become the task of this court after the remand is completed, and we invite the Commission to delve into it on the remand. In light of the fact that the operation of Transit's bus lines is now the responsibility of the Washington Metropolitan Area Transit Authority[392] by terms of the National Capital Area Transit Act of 1972,[393] it would be prudent for the Commission, in framing recommendations as to the precise restitutional relief to be accorded, to consult the Authority and to consider such proposals as it might be inclined to advance.

In so resolving this case, we have remained heedful of the recent passage of the legislation last mentioned, and the resulting public ownership and operation of Transit's transportation system in the Washington metropolitan area.[394] The takeover of Transit's system in no way af-

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[391] See text *infra* at notes 394-403. Our decision today in *Bebchick* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 3, disposes of part of the gain from the transfer of Transit's depreciable assets below the line by requiring that $252,688 of that gain be credited to Transit's riders' fund. See *Bebchick* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 3, Part VI at note 173.

[392] See note 394, *infra*.

[393] Pub.L. No. 92-517, 86 Stat. 999 (1972). See text *infra* at notes 394-403.

[394] The Act gave congressional consent to amendments to the Compact, *supra* note 12, empowering the Washington Metropolitan Area Transit Authority to "acquire the capital stock or transit facilities of any private transit company" and to "perform transit service . . . with transit facilities so acquired. . . ." § 101(a)(1), 86 Stat. 1000 (1972).

fects the disposition upon which we have settled. As we have held, correlative rights and obligations between Transit and its consumers spring from the invalidity of Order No. 773.[395] Those rights and obligations are as litigable as any others, and their enforceability against Transit survives the metamorphis of its transportation system from private to public ownership. While Transit's operating franchise ended immediately upon public acquisition of its facilities,[396] its corporate existence outlives that event,[397] and so also do its unassumed liabilities.[398] And while the Commission can no longer set fares for transit service,[399] its jurisdiction to finish existing litigation—

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[395] See text *supra* at notes 366-76.

[396] National Capital Area Transit Act of 1972 § 102(b), 86 Stat. 1001 (1972).

[397] The National Capital Area Transit Act of 1972 § 102 (d), 86 Stat. 1001 (1972), provides that Transit "may . . . continue to exist as" a District of Columbia Corporation and that "[n]othing in this Act shall be construed so as to cause or require the corporate dissolution of" Transit.

[398] It is well-settled that a cause of action in restitution is not terminated by the death of the transferor of the benefit or by the death of the recipient of it. Restatement of Restitution § 149(a) (1937). Applying this principle to the corporate "person" here, it is clear that Transit's restitutional obligations will survive the demise of its operating franchise.

[399] This follows from the Transit Authority Compact, *supra* note 12, which in art. XI, § 51, directs the Washington Metropolitan Area Transit Authority (Authority) to provide for the performance of transit service, with facilities owned or controlled by it, by contract with private transit companies, railroads or other persons; and in art. XIII, § 60, confers upon the Authority's board of directors exclusive jurisdiction to fix the rates and fares to be charged for service performed by transit facilities owned or controlled by the

otherwise than by ratemaking—remains intact.[400] Our disposition neither requires nor tolerates further ratemaking respecting the matters at issue,[401] but only restitutional activities occasioned by invalid ratemaking in the past.[402] Our disposition, too, leaves interested parties free to litigate to a complete and final conclusion the rights and obligations we have identified.

Order No. 773 is set aside. The record is remanded to the Commission for further proceedings consistent with this opinion. Our jurisdiction over the case is retained in full.[403]

So ordered.

Authority, and provides that the Commission "shall have no authority with respect thereto, or with respect to any contractor in connection with the operation by it of transit facilities owned or controlled by the Authority."

[400] The Transit Authority Compact, *supra* note 12, in art. XIII, § 59, provides that "[e]xcept as provided herein, this Title"—the Transit Authority Compact in its entirety—"shall not affect the functions and jurisdiction of" the Commission "as granted by Titles I and II of this Compact"—the Transit Regulation Compact in its entirety—"over the transportation therein specified and the persons engaged therein and the Authority shall have no jurisdiction with respect thereto." The National Capital Area Transit Act of 1972 did not authorize any change in this provision, nor did it disturb the Commission's existing jurisdiction over any carrier which furnishes service otherwise than as a contractor for operation of transit facilities owned or controlled by the Authority. The restitutional rights and liabilities remaining at stake in the case at bar arose, of course, while Transit operated as an individual carrier.

[401] See text *supra* at notes 351-56.

[402] See text *supra* at notes 366-76.

[403] Perhaps unnecessarily, but out of an abundance of precaution, we point out that the takeover pursuant to the

National Capital Area Transit Act of 1972 does not moot the issues which the proceedings on remand, and thereafter in this court, contemplate. While any question as to the continuing operability of an unsuperseded fare order might become moot at the point of takeover—a matter on which we express no opinion—no such question arises in this case. Order No. 773 has long since been displaced by later fare orders. See note 354, *supra*, and accompanying text. We have held that Order No. 773 is invalid and that it never had a valid operation. See text *supra* at notes 351-56. We reiterate that rights and liabilities were generated during the past era of the order's actual operation, the amounts of which await precise determination. See text *supra* at notes 366-76. The issues in that regard are not moot. See *Southern Pac. Co.* v. *ICC*, 219 U.S. 433, 452 (1911); *Curcio* v. *United States*, 354 U.S. 118, 127-28 n.7 (1957); *Bebchick* v. *Public Serv. Comm'n*, *supra* note 185, 115 U.S.App.D.C. at 218-19, 318 F.2d at 189-90; *Associated Press* v. *FCC*, 146 U.S.App. D.C. 361, 365 n.29, 452 F.2d 1290, 1294 n.29 (1971). Moreover, there are also special funds, including one in this very case, which have been set up under Commission control for purposes that remain unfulfilled. See, *e.g.*, *Bebchick* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 2; *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 354, 85 P.U.R.3d at 13; *D.C. Transit Sys., Inc.* (Order No. 773), *supra* note 311, 72 P.U.R.3d at 133-34. See also *D.C. Transit Sys., Inc.* (Order No. 952), *supra* note 211. The question of disposition of those funds—which the exigencies of restitution could affect—is not moot. *Market Street Ry.* v. *Railroad Comm'n*, 324 U.S. 548, 553 (1945). In sum, the need to resolve these problems keeps this litigation very much alive for the further proceedings this opinion envisions.

APPENDIX

COMMISSION'S STATEMENT AS TO HISTORY OF REAL PROPERTIES PURCHASED AUGUST 15, 1956, BY D.C. TRANSIT SYSTEM, INC., BUT THEREAFTER TRANSFERRED TO NONOPERATING STATUS

1. *M Street Shops,* 3222 M Street, N.W. (now known as M Street Estates, Inc.). This property was used as a general streetcar repair shop until June 30, 1963, when it was placed in a non-operating (below-the-line) status. From that time until May 31, 1964, it was used for storage of obsolete equipment. On May 31, 1964, title to the property was transferred to M Street Estates, Inc., which is wholly-owned by D. C. Transit of D.C. Since its incorporation, $1,106,210 has been spent on converting it into rental space for the General Service Administration. For the year 1969, M Street Estates had a net income of $74,519.64 and its retained earnings were $348,831.95 at December 31, 1969.

2. *Grace Street Shop* (now known as Grace Street Estates). The property housed the way department storeroom, an electrical repair shop and a garage for trucks until September 30, 1963, when it was placed in a non-operating (below-the-line) status. From that time until April 30, 1970, it was empty and unused. On April 30, 1970, title to the property was transferred to Grace Street Estates, a wholly-owned subsidiary of D. C. Transit System, Inc., of D.C.

3. *General Office Building, 3600 M Street, N.W.* (now known as 3600, Inc.). This property housed D. C. Transit's offices at the time D. C. Transit came into existence, but later was partially rented to outsiders. After being placed in a non-operating (below-the-line) status on January 1, 1964, the building was rented mainly to outsiders but continued to house a portion of the D. C. Transit offices, around 20% of the building space for a while, and then to 15%.

On December 31, 1967, title to the property was transferred to 3600 Inc., a wholly-owned subsidiary of D. C. Transit System, Inc. of D.C. Since being incorporated, the sum of $115,968 has been invested in office renovations and it is now being rented 100% to outside parties. In the year 1969, 3600 Inc., had net income of $8,486.29. Its retained earnings stood at $58,511.32 on December 31, 1969.

4. *Central Garage on Georgia Avenue, N.W.* (now known as Georgia Avenue Estates). This building was used as a bus garage until it was placed in a non-operating (below-the-line) status on September 30, 1958. After being placed below-the-line, it was leased to the Post Office Department. On May 31, 1964, title to the property was transferred to Georgia Avenue Estates, Inc., a wholly-owned subsidiary of D. C. Transit System, Inc., of D.C. Since then some $19,657 has been spent on building improvements while at the same time the Post Office Department has continued to be its tenant. The net income of Georgia Avenue Estates for 1969 was $29,547.36. Its retained earnings stood at $118,049.85 on December 31, 1969.

5. *Northeastern (Eckington) Carhouse* (now known as Fourth Street Estates). This property was used as carhouse until streetcar service was discontinued in that area of the city on September 7, 1958. After that, the building remained empty and unused until May 31, 1959 at which time it was placed in a non-operating (below-the-line) status. As non-operating property, it was rented to outsiders. On May 31, 1964, title to the property was transferred to Fourth Street Estates, Inc., a wholly-owned subsidiary of D. C. Transit System, Inc., of D.C. Subsequently, the sum of $472,628 was spent on building improvements. It is currently being leased as a warehouse to outside parties. In the year 1969, Fourth Street Estates realized net income of $15,804.66 and at year end (1969) its retained earnings stood at $22,030.92.

6. *Navy Yard Carhouse* (now known as L Street Estates). This property was used as a carhouse until the last street cars were discontinued on January 28, 1962. Obsolete equipment was then stored there. On June 30, 1963, the property was placed below-the-line (in non-operating status). It continued as a storehouse for obsolete equipment until the date of its incorporation, May 31, 1964. On that date title to the property was transferred to L Street Estates, Inc., a wholly-owned subsidiary of D. C. Transit System, Inc., of D.C. $392,384 has been spent on converting the carhouse to warehouse and office space for outside rental since its incorporation. 1969 net profits realized by L Street Estates were $62,391.74. Its retained earnings at December 31, 1969 were $274,281.18.

7. *Georgia and Eastern Avenue Terminal.* This property was used jointly as a rail terminal and bus terminal. Its use as a rail terminal was discontinued on January 3, 1960 and its use as a bus terminal ended on September 11, 1960. It remained unused thereafter. On October 31, 1960, it was placed in non-operating (below-the-line) status and subsequently sold, on December 21, 1962, to Joseph Ginsberg.

8. *Southern (7th Street) Carhouse.* This southeast property was used as a carhouse until it was sold on January 16, 1959 to the D. C. Redevelopment Land Agency.

9. *Fourth Street Shops.* This southwest property was used for general streetcar and bus repairs until it was sold together with the Southern Carhouse on January 16, 1959 to the D. C. Redevelopment Land Agency.

10. *Trinidad Garage.* This property was used as a bus garage until September 10, 1966. It was vacant thereafter until May 8, 1970, when sold to the D. C. Redevelopment Land Agency.

11. *Eastern Garage.* This property was used as a carhouse until December 31, 1961. It then became a bus garage and was used for that purpose until September 10, 1966, when it was vacated. It has been empty ever since although still classified as operating property on the company books.

12. *Brookland Garage.* This property was a bus garage until September 10, 1966. Since that date retired buses have been stored there. It remains in operating status on the books to this date.

MacKinnon, *Circuit Judge,* concurring in part and dissenting in part:

I. Summary and Introduction

The foregoing opinion addresses the question of whether the difference in fair market value over book value of certain parcels of real property including both depreciable (buildings and equipment) and nondepreciable (land) segments, which had appreciated in value during their in-service life, should inure to the benefit of the farepayers or to the benefit of the investors of Transit in the ratemaking decision, when transferred from operating ("above the line") to non-operating investment status ("below the line"). The question arises on review of Order No. 773 in which the WMATC ("Commission") ordered a fare increase without consideration of the transfer of these appreciated properties. The majority concludes that this constituted error and accordingly sets aside the order.

The initial question of whether such transfers from operating to non-operating status give rise to any cognizable gain in the ratemaking decision is resolved in the companion opinion—*Bebchick* v. *WMATC,* No. 23,720, at Part III, (hereinafter *Bebchick*). The conclusion reached therein is

that the transfer of the properties from above to below the line resulted in ratemaking consequences identical to those of an outright sale of the same assets. While in a different context and for different purposes such treatment would raise serious questions, I accept it for our present purposes.

In considering the competing claims of Transit's investors and consumers for the benefits derived from these transfers, the majority concludes that the farepayers have the superior claim in all instances. It is my view, with respect to the depreciable properties, that the majority is on solid ground in awarding the gain to the farepayers, at least to the extent of the depreciation reserves that are maintained in respect of the property.[1] While I have some question as to the farepayers' inexorable right to amounts over and above the depreciable cost of the asset,[2] I concur in awarding them the total appreciated gains under the circumstances present here.[3]

But the issues surrounding the appreciated value of the nondepreciable assets (the land itself), raise different and more difficult questions.

While the majority admits that a risk of loss analysis is inapplicable here due to the inevitable appreciation of urban land values, it blithely concludes without close analysis that the rules which place the risk of loss on farepayers as to depreciable property are equally applicable to nondepreciable assets. I would like to disassociate myself from

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[1] Throughout this opinion, when reference is made to the farepayers' right to receive gains to the extent of the "depreciation reserves," it is assumed that any depreciation deficiency due on the asset because of its premature retirement is first eliminated and the investors are compensated to that extent. *See also*, note 39, *infra*.

[2] *See* Part II B 2 a (2), *infra* at 113.

[3] *See* Part II B 2, *infra* at 108.

such dangerous dicta and will attempt to point out the flaws in the majority's reasoning. There *is* a rational basis upon which to distinguish between depreciable and nondepreciable assets in this context and the Commission's application of an accounting practice which reflects this should be upheld.

Aside from the risk of capital loss, the other principal reason the majority advances for its conclusion with respect to the land is a basic feeling that the equities of the situation, in light of the history and circumstances of Transit and its acquisition of the properties in question, require any "loose gains" coming into the company to be credited to the consumers. This the majority frames in terms of the rule "benefit follows burden,"[4] but admits that this consists in "determining where the equities lie." *Supra* at 51.

Most vital of these equities in the majority opinion is the fact that the land was intimately related to the conversion program from a street railway to an all-bus operation, and, since the extraordinary conversion costs were borne by the farepayers, any extraordinary gain resulting therefrom should benefit the farepayers and go toward alleviating their conversion burdens.[5] Since the conversion program was a *sine qua non* of the resultant gains, the majority observes, an overriding equitable consideration arises with respect to these conversion-related properties. While this has a surface attraction, there are some problems with its

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[4] *Supra* at 44. As discussed in my Part II B 2 c, *infra* at 118, this is to a considerable extent merely a restatement of the majority's risk of capital loss analysis. The better basis for its equity balancing method is the demise of the fair value system as discussed in Part III of the majority opinion, *supra*.

[5] For discussion of this conversion-relationship notion, *see* Part II B 2 a, *infra* at 109.

application here and with its interrelation with the other relevant policies.[6] Yet, even assuming *arguendo* that the majority is completely correct in its determination that equities surrounding the conversion can constitute a dispositive equitable factor, it does not extend, of course, to those properties not in any way related to the conversion program. It is with respect to those properties, the non-related, non-depreciable assets, that the greatest difficulty arises in adopting the position of the majority. Here the legal grounds for awarding the gains to the farepayers become most attenuated.

The underlying basis for the majority's equitable approach is that in light of the demise of the "fair value" theory of rate-making[7] investors are not considered to have any protectable constitutional interest in the actual assets of a publicly regulated utility but rather are entitled only to a fair return on their initial investment.[8] Therefore, arguably the logical extension of this is that any gains on disposal of appreciated properties are to be apportioned as between the farepayers and the investors solely on an equitable basis in light of all the relevant facts and circumstances. Although the question is not without difficulty, it is my view that this approach is incorrect as applied in the majority opinion. This constitutional policy sets only the *outer dimensions* of permissible ratemaking and is not a license for us to overturn Commission actions in conformance with accepted accounting procedures whenever we feel the equities tend to support a contrary result. It is thus my conclusion that the policy of judicial deference to

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[6] *See* Part II C *infra* at 120.

[7] *See* Part II C, *infra* and Part II of the majority's opinion, *supra*.

[8] That is, the figure used in fixing the rates is the original cost of the asset rather than the appreciated value thereof.

agency actions requires that we uphold this order in respect to the land as not arbitrary and capricious insofar as it distinguishes between depreciable and nondepreciable assets.

II. Nondepreciable assets

A. The example of depreciable assets

Much of the rationale behind the majority's view that the consumers would be liable for any capital loss on the land and therefore be entitled to any gains is derived by analogy to its analysis of the depreciable assets.

There is a respectable amount of authority both inside and outside this jurisdiction which supports the majority's disposition of the depreciable assets. The basic notion is that since the farepayers must make good the shareholders' investment on depreciable properties through the depreciation reserve, and bear the risk of loss through obsolencence in that they must make up for the underdepreciated cost of any prematurely retired asset, if the asset should be sold for a profit they equitably should benefit at least to that extent. If it is sold for less than book value they must make up the difference between that amount and the accumulated depreciation to date. Therefore, the reasoning goes, if it is sold at a profit it is only equitable that he who bears the risk of loss should similarly reap the gain.

The fundamental premise of this principle is that the farepayers *do in fact bear the risk of loss of obsolescence.* In *Washington Gas Light Co.* v. *Baker,* 88 U.S.App.D.C. 115, 188 F.2d 11 (1950), *cert. denied,* 340 U.S. 952 (1951), this court adopted this view and held, with respect to depreciable properties, that the farepayers may be charged with the unrecovered cost [9] if the investors have not been com-

[9] The method the court adopted to "charge" the farepayers

pensated in some other way.[10] A similar result was reached by Justice Murphy of the Minnesota Supreme Court in *Minneapolis Street Ry* v. *Minneapolis*, 251 Minn. 43, 86 N.W.2d 657 (1957) which held, citing *Baker* with approval, that the obsolescence loss occasioned by abandoned street-car facilities must be borne by the farepayers.[11]

When the retirement of the assets has resulted in a *gain*, a number of courts outside this jurisdiction have credited the gain to the depreciation reserve to offset the farepayers' burden of making good the investors' unrecovered costs,[12] and more importantly, there is ample authority within this jurisdiction for such treatment. In *D.C. Transit System, Inc.* (Order No. 4577) 30 P.U.R.3d 405 (D.C. Pub. Utils.

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was to leave the retired asset in the rate base thus increasing the return to the investors at the farepayers' expense. Under normal circumstances assets not "used and useful" in the company's operations are *not* included in the rate base.

[10] The two ways in which investors could have been already compensated for the risk are: (1) if through any accounting method (such as amortization) the investors have already been compensated; and (2) if the investor has been compensated by a higher rate of return because of assuming the risk. Minneapolis Street Ry. v. Minneapolis, 251 Minn. 43, 86 N.W.2d 657, 668 (1957).

[11] The method adopted by the court here for putting the loss on the farepayers was slightly different than in *Baker*. *Cf.* note 9, *supra*. The retired asset was not included in the rate base, but the company sought to amortize the loss over a 10-year period as an operating expense. "But in both cases [*Baker* and *Minneapolis*] the fundamental issue is whether the consumer or the investor will bear the loss." 86 N.W.2d at 667.

[12] In re Revision in Rates Filed by Plainfield-Union Water Co., 57 N.J.Super. 158, 154 A.2d 201, 205, 211 (1959); Minneapolis-Street Ry. Co., 31 P.U.R. 3d 141 (Minn. Ry. & Warehouse Comm'n 1959); Wyoming Gas Co., 40 P.U.R. 3d 509 (Wyo. Pub. Serv. Comm'n 1961).

Comm'n 1959), the PUC noted that under its Uniform System of Accounts a net profit on the sale of depreciable improvements should ordinarily be credited to the depreciation reserve as salvage (and thus benefit the farepayers).[13] In *D.C. Transit System, Inc.* (Order No. 245), 48 P.U.R. 3d 385 (WMATC 1963), "the Commission recognizes that 'gains' may be experienced on disposal of depreciable items and these are indeed used as offsets to depreciation under the heading of 'salvage.'" 48 P.U.R.3d at 403-04. Similarly, in *D.C. Transit System, Inc.* v. *WMATC,* 121 U.S.App.D.C. 375, 350 F.2d 753 (*en banc,* 1965), this court decided that the Commission's decision to benefit the farepayers with the gains from disposal of depreciable properties to the extent of the depreciation taken and beyond was reasonable in light of the peculiar equitable circumstances in that the farepayers were required to bear the enormous conversion costs that occassioned the gains realized.[14] The Commission has recently stated that "there is no question that, when depreciable operating property is sold and a gain is realized, the gain should be used to reduce the depreciation expenses which ratepayers have paid but which the company, because of the gain, does not actually incur." *D.C. Transit Sys., Inc.* (Order No. 1090), 85 P.U.R.3d 508, 513 (WMATC 1970).

Thus with regard to depreciable properties the approach adopted by the majority is well-supported and equitable but this does not justify a procrustean attempt to force non-depreciable assets into the same mold.

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[13] However, special circumstances dictated a sharing between consumers and investors. We affirmed in D.C. Transit Sys., Inc. v. P.U.C., 110 U.S.App.D.C. 241, 292 F.2d 734 (1961). *See* discussion *infra,* Part II B 2 a (2) at 113.

[14] *See* text accompanying note 55 *supra,* and further discussion *infra,* Part II B 2 a at 109.

B. Nondepreciable assets

1. Risk of capital loss

a. Precedents

Within the District, a number of administrative decisions have uniformly held to the contrary of the analysis adopted by the majority. This is admitted by the majority [15] but it is claimed that the administrative approach was adopted without critical analysis. Outside the District, there is a paucity of cases and the few that are cited cannot directly support the action taken here.[16] The majority observes the dearth of decided cases and seems to take this as a "license" to deal with the question as if writing on a clean slate. It would appear, however, that the lack of cases on point is probably more indicative of the fact that no one previously has ever imagined of or argued for such a novel approach with respect to nondepreciable assets.

Within the District, the issue has been mentioned in administrative opinions but we have never directly considered it.[17] Under both the PUC and WMATC, profits on sales of land have been treated as "a proper credit to earned surplus" and thus as benefiting the investors. *D.C. Transit Sys., Inc.*, (Order No. 4577), 30 P.U.R.3d 405, 409 (D.C. Pub. Utils, Comm'n 1959); *D.C. Transit Sys., Inc.*

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[15] *Supra* at 23.

[16] Aside from the cases discussed *infra*, the petitioners loosely cite *Baker* and *Minneapolis*, *supra* note 11 (petitioners' brief at 18), for their position on the land. However, as effectively pointed out in Respondent's brief (at 12-13) these cases dealt only with *depreciable* properties (plant and equipment) and have no applicability to nondepreciable real estate.

[17] The majority correctly states that none of our decisions upholding Commission orders can be interpreted as a decision on the merits of this issue.

(Order No. 563) 63 P.U.R.3d 32, 34 (WMATC 1966). More directly on point is *D.C. Transit Sys., Inc.*, (Order No. 245) 48 P.U.R.3d 385 (WMATC 1963) in which an argument very similar to the approach adopted by the majority here was advanced to the Commission and rejected by it. In that case it was argued that gains realized on the sales of certain pieces of land might be used to offset some of the losses on the premature retirement of rail facilities borne by the farepayers. In clearly holding to the contrary the Commission stated:

> While the ratepayers may have a claim to the depreciable property, at least to the extent of the depreciation reserves, *no such claim can be directed to land.*

48 P.U.R.3d at 399 (emphasis added).[18] And further:

> If land becomes of no further use and is disposed of at a profit, the investor is entitled to the profit; or, if at a loss, the investor must suffer the loss.

Id. at 400.[19]

Outside this jurisdiction, I agree with the majority[20] that the cases can be read only to stand for the proposition that the benefit of capital gains accompanies the risk of loss. In *New York Water Service Corp.* v. *Public Service Comm'n*, 12 App. Div. 122, 208 N.Y.S.2d 857 (1960) *affirming New York Water Service Corp.*, 7 P.U.R.3d 32 (N.Y. Pub. Serv. Comm'n 1955), the court upheld a determination by a regulatory commission which passed on to

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[18] The Commission's reasoning was correct simply *because* land is nondepreciable.

[19] It is true that the Commission cited Board of Pub. Util. Comm'rs v. New York Tel. Co., 271 U.S. 23, 32 (1926) in support of this analysis. While the majority's criticism of that case as standing for this proposition has my concurrence, *see* note 82 *supra*, it nevertheless appears that the Commission is correct and for reasons discussed *infra* that its conclusion can stand despite this faulty premise.

[20] *Supra* at 22.

the consumers a profit reaped on the sale of land. The controlling reason was that under the system of accounting adopted by that agency, any *loss* on a sale of land was required to be debited to the depreciation reserve and thus charged to the consumers. "The utility is thus protected from a loss in the sale of land in its operations; it seems reasonable it should pass on a profit to the consumer." 208 N.Y.S.2d at 863-64. Thereafter in *Lexington Water Co.*, 72 P.U.R. 3d 253 (Ky. Pub. Serv. Comm'n 1968), the same rule was applied by the Kentucky regulatory commission, citing *N.Y. Water Service*. "If it is proper to recover losses of non-depreciable property through amortization, then conversely it should be proper to amortize gain on such property." 72 P.U.R.3d at 259-60. Yet this decision was *reversed* by the reviewing court on the grounds that *N.Y. Water Service* was decided as it was *only* because of its unique accounting procedures—procedures absent in the Kentucky case.[21] The court believed that the risk of gain or loss had in fact been borne by the *investors*. *Lexington* v. *Lexington Water Co.*, 458 S.W.2d 778 (Ky. 1970). This case can, then, be cited in direct opposition to the approach adopted by the majority:[22]

> Profit made from the sale of non-depreciable land no longer used in serving customers is not an ingredient

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[21] The Kentucky agency had adopted a system of accounts providing for the charging of losses and for the crediting of profits on land sales, not to consumers, but rather to the utility's earned surplus account. 458 S.W.2d at 779.

[22] And note especially that this system was adopted in spite of the fact that Priest lists Kentucky as an original cost jurisdiction. 1 A. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 145-46 (1969). This figures importantly in evaluating the "fair value" analysis of the majority at Part III *supra*. *See*, Part II C. *infra*. Such accounting procedures are in fact compatible with original cost doctrines such as prevail in our jurisdiction.

> to be considered in fixing rates. The customers had no interest in the profit realized on the sale—it belonged to the stockholders.

Id. at 780. The majority also cites *Columbus Gas & Fuel Co.* v. *Public Utils. Comm'n*, 292 U.S. 398 (1934) as indicating that sudden losses in market value of land may conceivably be borne by consumers. However, the Supreme Court denied the claim because no such risk of value diminution from abandonment was imminent. Yet it appears that the Court would have allowed a system which treated land as a "depreciable" asset for all purposes (*see* note 25, *infra*) in which case the risk of loss would in fact be on the farepayers.

Therefore, while it is clear that the majority is correct in reading these cases as standing for "the broader principle that the benefit of a capital gain follows the risk of capital loss," [23] it clearly fails to recognize the importance of the applicable system of accounting and the Commission's practice and pronouncements in determining where in fact these risks do lie.

b. Who in fact bears the risk of loss?

(1) The Commission's pronouncements

It is clear that under the Commission's Uniform System of Accounts, land is treated as a nondepreciable asset and any gain or loss is a risk not of the farepayers, but of the investors.[24] Certainly the Commission could have adopted a different system placing the risk of loss on the farepayers

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[23] *Supra* at 22.

[24] "If land becomes of no further use and is disposed of at a profit, the investor is entitled to the profit; or, if sold at a loss, the investor must suffer the loss." D.C. Transit Sys., Inc. (Order No. 245) 48 P.U.R. 3d 385, 400 (WMATC 1963).

if it had so desired.[25] Yet the Commission has repeatedly said it is the investor's risk of loss. *D.C. Transit Sys., Inc.*, Order No. 245) 48 P.U.R.3d 385, 399, 400 (WMATC 1963); *D.C. Transit Sys., Inc.* (Order No. 4577) 30 P.U.R.3d 405, 409 (D.C. Pub. Utils. Comm'n 1959); *D.C. Transit Sys., Inc.* (Order No. 563), 63 P.U.R.3d 32, 34 (WMATC 1966); *see also* Respondent's brief at 9-10 and the Commission's brief in *Bebchick* at 32.

It is reasonable to adopt such an accounting method and as such it is beyond our power to overturn it, especially in light of consistent Commission adherence thereto. The Commission (as is usual with most regulatory agencies) has express statutory authority to establish uniform accounting rules[26] and such rules are controlling unless clearly arbitrary and capricious. *D.C. Transit Sys., Inc.* v. *P.U.C.*, 110 U.S.App.D.C. 241, 292 F.2d 734 (1961). Public utility regulation cases are replete with recitations of the principle that deference is to be accorded an agency's accounting treatment of various transactions unless clearly unreasonable. *See, e.g., American Telephone & Telegraph* v. *United States*, 299 U.S. 232, 236-37 (1936); *Northwestern Electric Co.* v. *FPC*, 321 U.S. 119, 124 (1944); *Arkansas Power & Light Co.* v. *FPC*, 87 U.S.App.D.C. 385, 185 F.2d 751 (1950); *see also infra* at 122-23. Accounting rules themselves reflect basic policy judgments carefully arrived at and should not be hastily overturned.

The reasonableness of a system of accounting which treats land as nondepreciable seems manifest. Land does

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[25] A system which allowed for "depreciating" land and charging the depreciation to the farepayers was apparently permissible in Columbus Gas & Fuel Co. v. Ohio Pub. Util. Comm'n, 292 U.S. 398, 410-11 (1934).

[26] Under the old PUC, the Code so provided. 43 D.C. Code §§ 309, 310, 314 (1951); *see* D.C. Transit Sys., Inc. v. P.U.C., *supra* note 13.

not wear out in the conventional sense of buildings and equipment. Neither is it a wasting asset such as resources subject to depletion allowances. Moreover while there obviously may be exceptions, as a general rule it is extremely unlikely that the fair market value of land in metropolitan areas would decrease below cost over a period of time.[27] This general stability of land values insures the integrity of the shareholders original investment in the vast majority of situations and it is just for that very reason that it is a widespread practice among regulatory agencies to treat land as nondepreciable. Under these circumstances it seems that the Commission's decision to treat land as a nondepreciable asset and to credit or debit any gain or loss on disposition to the earned surplus account is eminently reasonable and should be sustained. It certainly is a settled principle that land is nondepreciable and to call this is a "mistaken notion"[28] is wholly unjustified. It is familiar law that great deference is to be accorded consistently applied administrative decisions and interpretations of its own rules and regulations and here, as the majority admits,[29] the administrative decisions have uniformly treated gain or loss on land as a concern solely of the utility's investors.

(2) Criticism of the majority's conclusion in this regard

How then does the majority arrive at the conclusion that the risk of loss on land dispositions is borne by the farepayers? The answer is not completely clear,[30] but es-

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[27] This is also observed in today's companion cases Nos. 23,720 and 24,398.

[28] Text accompanying note 310, *supra*.

[29] *Supra* at 23.

[30] The majority refers to both depreciable and nondepre-

sentially the majority concludes that, in spite of what the Commission has done in the past and says it will do in the future, if faced with a concrete situation in which land becomes obsolete for the company's purposes and the market value drops below cost, if sold at a loss the Commission will place the burden of making good the original investment on the consumers just as is done with depreciable properties for which insufficient depreciation has been taken due to unforeseeable obsolescence.

The majority repeatedly speaks of "obsolescence and declining markets" with respect to land.[31] However, the concept of obsolescence in conjunction with land simply does not work. The truth of the matter is that if land is sold at a loss due to sudden obsolescence the loss falls on Transit's investors—and statements such as that in the text, *supra* at note 322, are simply wrong *as to land*. The only authority to the contrary is distinguishable easily on the basis of different accounting systems and different administrative practices in other jurisdictions.[32] There is no depreciation reserve mechanism as to land whereby farepayers must make good the original investment as in the case of depreciable properties—and it is the fact of *depreciation* that dictates the farepayers' burden as to depreciable properties, *not* the fact of possible fluctuations in market value. The hypothetical on pages 42-43 of the majority opinion insofar as it deals with land is completely erroneous. It simply states *ipse dixit* the startling conclusion that it is "the farepayers' burden to compen-

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ciable assets in the same breath with respect to risk of loss. *See, e.g., supra* at 47-50. However, on analysis, the only real threat of loss claimed by the majority as to *land* is declining market value due to obsolescence.

[31] *See e.g., supra* at 42-43, 49, 51.

[32] *See supra* at 101-03.

sate [investors] for the loss on their investment in the land." For authority, footnote 194 refers to cases (text and cases at footnotes 211-18) that deal exclusively with *depreciable* property and are of no authority for the proposition stated. Repeatedly the majority speaks of "obsolescence" as to land but refers the reader only to cases involving obsolescence as to *depreciable* property.[33] Such citations beg the very question before us which is *whether or not* the treatment accorded depreciable property should be extended as well to nondepreciable assets. While there might be some "inside information" that is not apparent, it stretches credulity to suggest that the Commission would depart from its own system of accounting and repeated past administrative pronouncements to place the risk of decline in market value of land through obsolescence on the farepayers. And to use that as an ostensible basis for awarding the farepayers the gains on that property is tortured logic at best.

The majority does conclude that even though this analysis would support an award of the gains to the farepayers if there were a palpable risk of declining markets, that risk is not present here.[34] Thus it appears that the "obsolescence" of which the majority speaks is in reality only the threat of declining market values. And I must repeat that this again demonstrates that "obsolescence" is a concept applicable only to depreciable property in

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[33] The identical cases are cited for both nondepreciable and depreciable assets. *Compare* note 194 *with* note 192 *supra*.

[34] On the other hand, the argument can always be made that just because most land values have consistently risen in our times, that does not mean they will invariably continue to do so. And there are conceivable hypothetical situations in which, for example, certain easements useful and valuable while in service, become totally worthless when transferred to nonoperating status (*e.g.*, track easements down the center of a street).

this context. It is not the risk of sudden declines in market value of *depreciable* property that dictates the award of gains to the farepayers, but rather the *fact* of depreciation, in that farepayers are required to make good the *cost* investment of the prematurely retired asset through the depreciation mechanism. And this in turn is founded, of course, on the fact that depreciable property invariably wears out or is consumed. This simply has no application to nondepreciable property and it is undisputed that land is nondepreciable. Accounting principles are not conjured up out of the air, but are themselves representative of studied policy judgments. As such they deserve some respect and where an administrative agency consistently adheres to them, that should not be the subject of *de novo* judicial examination.

Moreover, the majority does not even maintain internal consistency. Even while disclaiming any reliance on "risk of capital loss" as to land in this case due to the inevitability of land value appreciation,[35] the majority seems unable to refrain from further gratuitous reference to that doctrine to lend support to its result.[36] It also reappears in discussing the supposedly distinct ground of "benefit follows burden" (the dispositive ground in the majority's opinion) and figures importantly there, despite the prior disclaimer of reliance thereon for the purposes of this case.[37]

2. Equities

Since notions of risk of loss cannot and do not support the majority's disposition of the gains from land, what

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[35] I find it inapplicable on more fundamental grounds.

[36] *See, e.g.*, text accompanying notes 325, 327, *supra; see also* Part II B 2 c, *infra* at 118.

[37] *See* Part II B 2 c, *infra* at 118.

other grounds are advanced in the opinion? The second and controlling "doctrinal consideration" in the majority opinion is termed "economic benefit follows economic burden". The makeup of these "burdens" is crucial. A large part of this consists of enumerating the various equities of the farepayers in light of the history and circumstances of Transit.[38] My brief analysis of these equities follows.

a. Conversion-relationship

Running all through the opinion is a basic equitable notion that gains on properties which are intimately related to the conversion to an all-bus system undertaken by Transit as a condition of its charter, should inure to the consumers who are bearing the enormous costs of the conversion program. It is undisputed that consumers are bearing the $5-15 million cost of the conversion. In the majority opinion, this fact leads to the conclusion that "the crowning consideration [in totaling the various equities] is the incontrovertible fact that the conversion, at full cost to the farepayers, was the *sine qua non* to release of value properties from operating roles in the transportation scheme for uses in non-transportation ventures." *Supra* at 61. While the proximity of the relationship of the land to the conversion process is an important equitable factor, it is *not* a legally sufficient ground in and of itself to support the majority's result. To dispel all such doubt, the following analysis seeks to trace the proper role of "conversion-relationship" in light of past precedents.

(1) Precedents

This concept is derived from cases *in this jurisdiction* indicating that with respect to *depreciable* properties for which obsolescence losses are incurred due to the conver-

[38] *But see Id.* An equally large part consists of a restatement of the first "doctrinal consideration."

sion, consumers should be allowed to *share* equitably in the proceeds on disposition. How this principle developed and to what extent it is applicable here requires a close analysis of the cases in which it has appeared.

It first arose in *D.C. Transit Sys., Inc.*, (Order No. 4577) 30 P.U.R.3d 405 (D.C. Pub. Utils. Comm'n 1959). In that case there were profits on the sale of conversion-related properties over and above the depreciable cost of the assets.[39] The PUC noted that under its Uniform System of Accounts, *all* gains normally should be credited to the depreciation reserve as salvage (to benefit the consumers). *Id.* at 410. Then it observed that this was a highly unusual situation in that there were gains over and above the amount needed to retire the original cost of the assets and therefore departure from the Uniform System of Accounts was deemed warranted. The company sought the "over and above" gains in total, but the PUC noted the compelling equity of the close relation of the gains on these properties to the conversion program.[40] This is

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[39] Throughout this opinion, the term "over and above" gains will be used to refer to gains realized on the disposition (or transfer below the line) of a depreciable asset, over and above the depreciation reserves (that amount contributed by the farepayers toward the depreciation of the asset) and assumes that any depreciation deficiency due to premature retirement of the asset is also covered by the gains. Thus it is profit over and above the total original depreciable cost of the asset.

[40] In ordering Transit to allocate the proceeds of the sale in the manner described, the PUC declared:

> "In light of the franchise of the company requiring a gradual program of conversion from railway to bus operations over a 7-year period from July 24, 1956, we are unable to disassociate the instant transaction from the imminent retirement of all rail property under the mandate contained in the franchise. We cannot ignore the probability that full provision for depreciation will

somewhat odd because the PUC really approached the question "backwards." That is, since the Uniform System of Accounts required *all* gains to go to the farepayers, why should it not have searched for some equities on the side of the *investors* rather than the farepayers. Somehow the PUC seemed to adopt a presumption that all "over and above" gains should now go to the investors, contrary to its own Uniform System of Accounts.

Nevertheless, this approach was later cited by this court sitting *en banc* as a valid method of determining when gains on depreciable property (presumably over and above the depreciation reserve although this is not clear) can be applied to offset other charges arising out of the conversion. In that case the question was whether a profit on the depreciable portion of an asset [41] could be used to offset an obsolescence charge for the retirement of a different asset, underdepreciated due to the conversion. The court seemed to say the profit on one piece of depreciable property could not be used to offset the obsolescence deficiencies on another asset unless the requisite relationship

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not have been provided when the rail facilities are abandoned and retired by reason of conversion. The company has consistently taken the position that any retirement loss in this connection should be recovered by charges against the customers, and the staff has heretofore indicated its agreement. However, if the customers are to be required to bear the burden of extraordinary retirement losses incident to the whole conversion program, it appears equitable that they should share, at least to some extent, in extraordinary retirement gains of the nature here under consideration."

D.C. Transit Sys., Inc., 30 P.U.R.3d 405, 412 (D.C. Pub. Utils. Comm'n 1959).

[41] The asset, the "Georgia & Eastern Terminal," apparently consisted of land and structures and thus had both depreciable and nondepreciable components. The discussion in this case, dealt only with the *depreciable* segments.

to the conversion were established. 350 F.2d at 775-76. The court remanded to the Commission to determine whether the profit-yielding property was in fact conversion-related.

On remand, however, the Commission further clouded the question. After determining that the property in question was *not* conversion related (which would have settled the issue) it continued:

> Therefore, the ratepayer is not entitled to share in any portion of the proceeds of that sale, unless there was a profit on the depreciable portion of the asset sold. There was none in this case.

D.C. Transit Sys., Inc., (Order No. 563), 63 P.U.R.3d 32, 33-34 (WMATC 1966). This is confusing in that the Commission seemed to say in a casual manner that if the sufficient conversion-relationship *were* shown, the farepayers would have a right to the profit on nondepreciable assets —a principle it has *never* accepted. It is correct in that farepayers are entitled to profits on depreciable properties to some extent regardless of the conversion relationship. And since there was none here, farepayers are not entitled to any portion of the proceeds of the sale. The tricky word is "therefore" and it must be concluded that this is merely ill-considered loose language on the part of the Commission.

The principle boils down to this: farepayers may get the gains on depreciable properties in all situations on that particular asset up to the depreciation reserve, but gain over and above that[42] will not be credited to offset other depreciation obligations incurred on other assets due to the conversion program unless the gains also were occasioned by the conversion. This is a reasonable approach, although it is based on the Commission's rather surprising position of inclining to give all "over and above" gains

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[42] *See* note 39, *supra*.

to the company rather than to the farepayers as is required under its Uniform System of Accounts. Apparently the Commission felt that its accounting procedures never contemplated such extraordinary gains over and above depreciation reserves—and it is true that the whole premise of depreciation is that an asset will usually decline in value to the point of an insignificant predicted salvage figure.

(2) "Over and above" gains on depreciable assets

This raises the difficult question of whether farepayers should automatically be entitled to these "over and above" gains. The majority maintains at footnote 227 (last two sentences) that because the farepayers bore the risk of loss up to the total cost of the asset, equitably they should receive the total gain. Since the investors are assured protection of their investment, the majority argues, they have no equitable claim to any gain. However, the better analysis seems to be that the farepayers must undertake in *all* situations to make good the original cost of the asset to the investors because it is assumed that the asset will be consumed in the business and its value dwindle to the point of salvage. This was the expectation in setting up the depreciation schedule and in estimating the useful life of the asset. When these calculations go awry and the salvage value is somewhat higher than predicted, clearly the farepayers should get back their contributions to depreciation to that extent—and this is how the Uniform System of Accounts works. However, when calculations are so far afield that the depreciable asset on retirement brings in not only the total cost, but a sizeable profit as well (a highly unlikely situation), the farepayers in recovering back *only* the amount of their contributions to depreciation and in being relieved of any further depreciation obligation in respect of the asset, nevertheless are re-

ceiving an unexpected windfall to that extent. When there is a sizeable profit as well, it seems the Commission is completely justified in departing from normal accounting procedures as it did in *D.C. Transit Sys., Inc.*, (Order No. 4577) 30 P.U.R.3d 405 (D.C. Pub. Utils. Comm'n 1959) and allow both investors and ratepayers to share in these over and above gains according to the equities—one of which is the relation the property bore to the conversion and the enormous obsolescence charges associated therewith. This would appear to be the better rule but I concur in the result reached by the opinion which gives the over and above gains on depreciable properties to the farepayers because of the equities of this particular case.[43]

(3) Analysis of the majority's use of the concept of conversion-relationship with respect to the land

How then does the majority employ the notion of conversion relationship? While at times the majority uses it only as another equitable factor (a role I deem appropriate), at other times it appears to be a dispositive legal consideration. *See supra* at 65-66. I would simply like to clarify the point that language in our past opinions dealing with conversion relationship has referred solely to depreciable properties and, as discussed above, there is indisputably a rational basis for distinguishing nondepreciable property in this context.[44] Any past discussion of conversion relationship has been with respect to depreciable property already prima facie awarded to farepayers under the Uniform System of Accounts and has involved questions as to the appropriate *sharing* between investors and farepayers as to gains over and above the depreciable cost of the asset. Here, under the Uniform System of Ac-

[43] For non-conversion-related equities, *see* Part II B 2 b, *infra* at 116.

[44] *See supra* at 104-05, 107-08.

counts, duly adopted by the Commission, the gains on real property automatically go to *investors* as discussed *supra*. Moreover, under the applicable precedents, once a conversion relationship is found to exist, only then does it become a matter of balancing the equities to determine to what extent farepayers shall share in the proceeds. "The extent to which they are to share depends upon a fair balance between the interests of the public and those of the company's investors." *D.C. Transit Sys., Inc.* (Order No. 4577) 30 P.U.R.3d 405, 412 (D.C. Pub. Utils. Comm'n 1959).

(4) Summary

Therefore, to summarize the precedents insofar as they address this issue, on close analysis, the method appears to be this: if depreciable property is sold at a gain, those gains belong to the farepayers up to the point of the depreciation reserve of the asset. If there remains any gain over and above that figure, it must be determined whether these properties in question were disposed of as part of the conversion program. If so, *then* the other equities are examined to balance the relative interests of the public and the consumers. Thus the depreciable nature of the property is an essential prerequisite to any conversion-relationship analysis; and in turn, a conversion-relationship is a necessary predicate to any balancing of the equities. In no way is there any precedential support for applying either a conversion relationship analysis or a balancing of the equities to *nondepreciable* assets. That is not to say that the fact of the conversion relationship does not create a powerful equity—but rather that any reliance on this concept as an independent source of support based on precedent is misplaced. And certainly with respect to nondepreciable properties *not*related to the conversion, the only conceivable ground for the opinion's similar disposition of the gains in favor of the farepayers is simply

the general equities of the situation [45]—which leads to the following discussion.

b. Other equitable considerations

It is indisputable that the equitable considerations involved in this case preponderate in favor of the farepayers. They have been required to bear the burden of over $10 million in track removal and repaving as well as the $5 million underdepreciated cost of the tracks and streetcars. Moreover, the fact that the conversion program borne by the farepayers freed these parcels of real estate to be disposed of at a profit by the investors is a very compelling equitable consideration.[46] Transit's investors benefited from a purchase of the stock of the company at a cost far below the fair market value of the assets,[47] (not

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[45] It is recognized that these nonrelated nondepreciable properties represent a very small portion of the assets involved.

[46] In this regard it is also noteworthy that the farepayers must bear the cost of maintenance on the properties while in operating status.

[47] At the time of acquisition the assets were valued on Capital's books at approximately $23.8 million. Transit's purchase price was about $13.5 million—but the investors had to make up the $10 million difference through the acquisition adjustment account as described in the majority opinion. However, the *market value* of the assets was apparently somewhat higher, exactly how much higher being a debatable point. *See* majority opinion, *supra* at n.11. It should be noted that technically Capital was acquired by Transit through a purchase of stock. Text accompanying note 257, *supra*. The majority consistently fails to make a distinction between acquisition by purchase of the assets and by purchase of stock. *See, e.g., supra* at 52. It would have been more precise to maintain this distinction between the two methods, especially since it partially explains the purchase price below book value.

The principal reason behind this "bargain" in the pur-

to mention not paying any sort of premium for acquiring a going business with a virtual monopoly assured by charter) and it appears that sizeable dividend returns have been received over the years.[48]

I must note briefly however, that some dispute can be taken with some of the specific factors in the majority opinion. For example, some of the factors cited as benefiting the investors, such as Transit's virtual monopoly position (*supra* at 59), its preferred tax treatment (*supra* at 69), its changeover to an operating ration system of fixing a fair return as opposed to the old rate base method (*supra*

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chase of Capital's stock was simply that there were no other acceptable offers at the time. The legislative history of the Franchise Act shows that the Senate originally passed a version under which the transit system would be publicly owned for an interim period of three years until a suitable buyer could be found. S. REP. No. 1791, 84th Cong., 2d Sess. (1956). Prior to this "proposals were received from six applicants for the permit and detailed conferences were held with each. However, the Public Utilities Commission reported that none of the applicants met the requirements considered essential for the issuance of a permit, and no further proposals by private individuals have been submitted to date." *Id.* at 2. Since private ownership was deemed preferable, the conference report indicated that the final arrangement ultimately agreed upon to give the franchise to Transit was considered more acceptable. H.R. REP. No. 2751, 84th Cong., 2d Sess. (1956). It was apparently a simple case of the price being driven down by a dearth of buyers. It is apparent that the prospects were somewhat less than attractive.

[48] On page 60 of the majority opinion, enormous dividends are alluded to. This figure was derived from the Committee Report cited at note 271, but is based on a comparison with the $500,000 cash investment figure rather than the $13.5 million original investment in the company and as such is somewhat misleading and emotional. Since those years, Transit's investors have apparently been doing substantially worse. *See*, No. 24,398.

at 58), and the general rise in property values (*supra* at 61), are present in almost every case involving a public utility. To weigh these factors against the investors is tantamount to "fixing" the outcome of the game before it begins. Moreover, we read nowhere in the majority opinion of any equities on the side of the investors. A regulated public utility is a unique operation in which it is often said the investors have only a "fishing license." While they stake their entire investment in the enterprise and face a large downside risk, they have a ceiling on their possible gains (a regulated reasonable rate of return)—and they are not guaranteed this return, but only given the right to "fish" for it. In return for agreeing to this arrangement, they receive a number of advantages such as their monopolistic position, tax preferences and perhaps an operating ratio method of rate determination. Where the investors must bear the entire business risks, consumers bear only the incidental maintenance costs on utility assets and must protect the investors' investment in depreciable property since it has a limited useful life (but not land—land stability is their only protection here). That this arrangement has long been the practice in public utility regulation is admitted by the majority. Yet never before have such factors been considered equitable considerations which militate against the investors, at least to my knowledge. To so hold is equivalent to saying that in every case the equities are against the utility. In our case it is true that the conversion has placed *extraordinary* burdens on the farepayers—and it is these extraordinary burdens which rightly should figure in the equitable balancing process. But I object to "stacking the deck" by adding into the balance the normal incidents of every publicly regulated industry.

c. Resurrection of "risk of capital loss" under the topic heading of "burdens"

As conceded above, a large part of these "burdens" consist of various equitable factors which weigh generally in

favor of the farepayers. However, it seems that an equally large part of the majority's rationale in this "benefit/burden" section is nothing more than a restatement of the erroneous principle that farepayers are entitled to capital gains because of the obsolescence risk of capital loss— *i.e.*, the *first* of the majority's two controlling principles. While supposedly discarding that factor for the purposes of this case,[49] the majority somehow manages to slip it back into the deck with an impressive sleight of hand maneuver. Repeatedly in this section of the majority opinion, there is language about "depreciation" and "obsolescence" burdens of the farepayers.[50] The fact of the matter is that such concepts *simply do not apply to nondepreciable assets* such as land. Such statements as "consumers bear the risk of that loss unless investors have been compensated for assuming it" (text accompanying note 217, *supra*) are completely wrong as to land. What is more important is that they involve identical considerations to those the majority claimed to have set aside.[51] Here we have two basic doctrines advanced to support the result and one consists to a considerable extent of a restatement of the other. And when it is asserted that the one factor is to be shelved, it should not reappear in another form. If truly consistent in this regard, what then would remain of the majority's crucial second "doctrinal consideration", the dispositive benefit/burden analysis? When the repeated doctrine disappears, we are left with only "half a doctrine." On careful scrutiny, then, the marvelously voluminous and superficially authoritative arguments for the existence of in-

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[49] I feel it is incorrect as to all cases involving land, of course.

[50] *See* text accompanying notes 197, 199, 200-04, 209, 211, *supra*.

[51] "At the outset, we lay aside the rule that capital gain accompanies risk of capital loss." *Supra* at 51.

creased farepayer burdens evaporate, leaving a much lightened scalepan on the farepayers' side of the equity balance.[52]

C. The critical inquiry.

As to the central issue, I find myself in agreement with the majority. The statement that "accounting directives . . . must survive the test of rationality" (text accompanying note 316, *supra*) precisely frames the question as I would desire. Clearly then our difference centers around whether the majority's "equities" are sufficient to render the Commission's actions irrational, arbitrary and capricious.

To be sure, there is no question that the Commission is not bound by traditional concepts of private enterprise and private property in its treatment of various transactions—at least not by any constitutional considerations. The cases rejecting the fair value theory of rate base and depreciation[53] have demonstrated a marked willingness to accept commission departures from such restraints in public utility ratemaking. As the majority opinion points out, the Supreme Court has said that "under a statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. . . . It is not the theory but the impact of the rate order that counts." *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). Therefore conceivably we should look only to the relevant facts and circumstances and proceed to balance the equities. This is essentially what the majority does with respect to the nondepreciable nonrelated properties and, under my analysis what it *must* do with respect to all the land since there

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[52] Consisting of the factors I have summarized in Part II B 2 b, *supra* at 116-18.

[53] Part III of the majority opinion, *supra* at 26-38.

does not appear to be any other persuasive justification for the result reached.

Yet while such an approach may be *constitutionally* valid and would undoubtedly be upheld had the agency in fact adopted it, we are not faced with such a situation nor are we operating in a vacuum. There enters another very powerful judicial doctrine—that of deference to agency adeherence to rules promulgated under statutory authority unless *arbitrary and capricious*. Again the ultimate question is whether the equities of the situation are so overwhelming that we can say that the Commission's *adherence* to its Uniform System of Accounts and its uniform administrative pronouncements was clearly arbitrary and capricous under the circumstances. It is my conclusion that the Commission's actions were reasonable enough to withstand attack on review. It is true that a system of accounting which is unreasonable may be overturned by this court, yet I cannot agree that because of the equities in this case, the traditional manner of accounting employed here is such a departure from economic realities as to warrant a finding of arbitrariness. Clearly if the Commission were to adopt an accounting procedure like that employed in *N.Y. Water Service*[54] we would uphold its decision and we now would have before us a different case. Moreover the equities on careful analysis are not so overwhelming as the majority would like to paint them. Many of the numerous factors cited by the mapority are makeweights and the valid ones are insufficient to render the Commission's actions arbitrary and unreasonable. The apparent *de novo* review of the agency's procedures in the opinion and the wholly unprecedented treatment of the nondepreciable properties based solely on equitable balancing seems to be stretching the law to reach a desired result.

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[54] *Supra* at .

It is clear that the majority gives very little deference to the applicable accounting rules and the Commission's decision to follow them.[33] It states that "accounting procedures are not self-justifying" and "to permit an accounting device to dictate the rule of law is to allow the tail to wag the dog. To judicially accept an accounting method without inquiry as to its reasonableness is to pervert the law. And to yield, on judicial review, unquestioning obeisance to administrative authority over utility accounting is to abdicate the responsibility to review." *Supra* at 69. Yet while the judicial responsibility to review, certainly should not be abdicated, neither is it a license to ignore all limits on our discretion. It is the majority, rather, that "perverts" the law in ignoring such firmly embedded concepts in our judicial system as deference to agency procedures. The Supreme Court has spoken decisively on this issue:

> This court is not at liberty to substitute its own discretion for that of administrative officers who have kept within the bounds of their administrative powers. *To show that these have been exceeded in the field of action here involved, it is not enough that the prescribed system of accounts shall appear to be unwise or burdensome or inferior to another. Error or unwisdom is not equivalent to abuse. What has been ordered must appear to be "so entirely at odds with fundamental principles of correct accounting" (Kansas City Southern Ry. Co. v. United States,* 231 U.S. 423, 444) *as to be the expression of a whim rather than an exercise of judgment. Norfolk & Western Ry Co. v. United States,* 287 U.S. 134, 141; *Kansas City Southern Ry. Co. v. United States, supra,* p. 456.

American Telephone & Telegraph Co. v. United States, 299 U.S. 232, 236-7 (1936) (emphasis added). *See also, North-*

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[33] This is also the approach taken by the majority in 24,398. There the majority refers to the applicable accounting system but cavalierly dismisses it as a "technical point." No. 24,398 at 26.

western Electric Co. v. *FPC*, 321 U.S. 119, 124 (1944) (emphasis added):

> Although . . . the Commission's prescribed method of eliminating the write-up may not accord with the best accounting practice, it is sustained by expert evidence. *It is not for us to determine what is the better practice so long as the Commission has not plainly adopted an obviously arbitrary plan.* [footnotes omitted].

See also, D.C. Transit Sys., Inc. v. *PUC*, 110 U.S.App.D.C. 241, 242, 292 F.2d 734, 735 (1961); *Arkansas Power & Light Co.* v. *FPC*, 87 U.S.App.D.C. 385, 185 F.2d 751 (1950); *Alabama Power Co.* v. *FPC*, 75 U.S.App.D.C. 315, 128 F.2d 280, *cert. denied*, 317 U.S. 652 (1942); *Pacific Power & Light Co.* v. *FPC*, 141 F.2d 602 (9th Cir. 1944); *Pennsylvania Power & Light Co.* v. *FPC*, 139 F.2d 445 (3d Cir. 1943), *cert. denied*, 321 U.S. 798 (1944). To dismiss such an established and sound principle of law so cavalierly is wholly unjustifiable.

I repeat, the majority accords no deference to consistent administrative adherence to widely accepted established accounting procedures—themselves a product of careful policy judgments. It would rather consider each situation individually on the basis of the equities. This effectively injects our court into the regulatory process without benefit of expertise and creates an environment in which we are allowed to give free reign to our equitable inclinations on each factual situation without the restraining parameters of an orderly accounting system. This violates fundamental notions of administrative law and the role of the judiciary.

Brief mention is required as to the majority's claim that it has been cited to no operative accounting rule on the issue at hand. This selective blindness is difficult to understand. Surely the majority does not mean to dispute the *existence* of a Uniform System of Accounts. The PUC, for example, repeatedly referred to it in *D.C. Transit Sys., Inc.*, (Order No. 4577) 30 P.U.R.3d 405 (D.C. Pub. Utils. Comm'n 1959):

"while cognizant of the desirability of adhering to the Uniform System of Accounts . . ." (Id. at 410); "starting from the conceded premise that a strict application of the Uniform System of Accounts requires . . ." (*Id.*); "the Uniform System of Accounts, applicable to accounting procedures of utilities under the jurisdiction of this commission . . ." (*Id.*). On this precise point the Commission has *informed* us in its brief that: *"Under the system of accounts now in effect,* where property is transferred by Transit from an operating to a non-operating status because it is no longer needed in the company's transit operations, the following results:

> (2) As to non-depreciable property, that is property for which no depreciation charge is assessed against the ratepayer, a different result ensues. In this case, the property is merely removed from the rate base at original cost. If there is a gain, that is if the fair market value exceeds original cost, or if there is a loss, there is a credit or charge made to retained earnings, so that the investor receives the full benefit of any gain and the full detriment of any loss.
>
> Depreciable property is a capital item which the investor has put into service which, while it remains in service, is wearing out. As it wears out and thus its value is reduced, the ratepayer reimburses the investor for the reduced value through a depreciation charge which is set to reflect the rate at which the property is assumed to be wearing out. At the time of transfer, the amount of the accumulated depreciation is deducted from the original cost to determine the unrecovered cost. If the fair market value exceeds the unrecovered cost, there is a gain in that amount, and it is fair that the gain be credited to the ratepayer up to the amount he contributed in depreciation charges for that property. At the same time, if the gain exceeds the amount needed to repay the ratepayer in full, it seems equitable that the investor receive that surplus.
>
> With respect to *non-depreciable property,* on the other hand, since the ratepayer makes no contribution to the capital cost, he shares none of the profit if a

> profit is indicated when the property is taken out of service. The investor has provided the capital to acquire the property and the ratepayer in no way thereafter has provided reimbursement to the investor for that capital outlay, as he has through depreciation charges on depreciable property. While nondepreciable property is in service, the ratepayer pays maintenance and taxes on the property, which expenses are regarded as legitimate operating expenses; but they do not represent a contribution to the capital cost. That cost is borne by the investor; thus, when the nondepreciable property is removed from service, it is equitable that any gain in value over original cost be passed on to the investor.

Respondent's Br. 9-11 (emphasis added). Now is this a failure to cite to us the Commission's Uniform System of Accounts as the majority contends? Is it defective because no section numbers or quotations appear? Or does the majority simply assume that the Commission has lied to us? I think such an assumption wholly unjustified and improper to say the least. Moreover, this cannot be a "post hoc rationalization" since, as the majority admits,[56] the Commission has repeatedly and consistently stated this to be its position and this statement is not contradicted in this record.

A Uniform System of Accounts is not enacted piecemeal. This Agency's system has been in effect since the days of the PUC and the WMATC clearly inherited it *in toto*.[57] It is a broad system of accepted accounting procedures applicable to all regulated industries under the Commission's authority. The enactment of Regulation 61 was necessary because it is in *abrogation* of traditional accounting rules. No such regulation is required where the disposition is in *conformance* with such accounting principles.

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[56] *Supra* at 23.

[57] *Supra* note 306.

And even were there no clear Uniform System of Accounts provision on this issue, my position would be precisely the same. The policy of deference to consistently applied agency procedures and practices in areas of its expertise and authority is well established and incontrovertible. No such deference has even momentarily given the majority pause in its zeal to deal with the issue *de novo*.

Finally, if a close conversion relationship in conjunction with the other equities favoring the farepayers did serve to render the Commission's accounting practices and administrative decisions manifestly unreasonable and arbitrary, there would be insufficient support for this result as to the *non*related nondepreciable properties. The fact that the conversion program, the cost of which was borne by the farepayers, was the *sine qua non* of the gains realized by the investors on the related properties is a strong and appealing equitable factor. And, when joined with the other equitable considerations weighing in favor of the farepayers, I can certainly sympathize if not concur with, the notion that this renders the Commission's accounting procedures unreasonable. However, where the factor of conversion-relationship is absent, it seems clear that it cannot conceivably be said that the general equities alone reach the "critical mass" necessary to a finding of "arbitrary and capricious."

I thus dissent as to all the land (both related and nonrelated to the conversion) and, while concurring in the result as to the depreciable properties, would like to make clear my view that the "over and above" gains should not be considered as inexorably belonging to the investors.

APPENDIX B

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 24,398

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, *et al.*, PETITIONERS

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, RESPONDENT

D. C. TRANSIT SYSTEM, INC., INTERVENOR

No. 24,415

DISTRICT OF COLUMBIA, PETITIONER

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, RESPONDENT

D. C. TRANSIT SYSTEM, INC., INTERVENOR

No. 24,428

BLACK UNITED FRONT, PETITIONER

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, RESPONDENT

D. C. TRANSIT SYSTEM, INC.,
WASHINGTON CONSTRUCTION AREA INDUSTRY TASK FORCE, INTERVENORS

Petitions for Review of An Order of the Washington Metropolitan Area Transit Commission

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Decided June 28, 1973

Landon G. Dowdey, with whom *S. David Levy* and *Neil J. Cohen* were on the brief, for petitioners in No. 24,398.

C. Beldon White, II, Assistant Corporation Counsel for the District of Columbia, with whom *Hubert B. Pair,* Acting Corporation Counsel at the time the brief was filed, and *George F. Donnella,* Assistant Corporation Counsel at the time the brief was filed, were on the brief for petitioner in No. 24,415.

Jean Camper Cahn for petitioner in No. 24,428 and intervenor Washington Construction Area Industry Task Force.

Douglas N. Schneider, Jr., General Counsel, Washington Metropolitan Area Transit Commission, for respondent.

Harvey M. Spear for intervenor D. C. Transit System, Inc.

Gilbert Hahn, Jr., Chairman of the City Council of the District of Columbia at the time the brief was filed, *pro se,* with whom *Louis F. Oberdorfer* was on the brief, as *amicus curiae.*

Before ROBINSON and MACKINNON, *Circuit Judges*, and DAVIS,* *Judge*, United States Court of Claims.

Opinion for the Court filed by *Circuit Judge* ROBINSON.
Opinion concurring in part and dissenting in part filed by *Circuit Judge* MACKINNON, at p. 57.

ROBINSON, *Circuit Judge*: By these three petitions, we are summoned to review aspects of Order No. 1052[1] of the Washington Metropolitan Area Transit Commission authorizing increases in the fares chargeable by D.C. Transit System, Inc. (Transit) for bus transportation in the District of Columbia and adjacent areas in Maryland and Virginia.[2] Having done so through careful consideration of the parties' contentions and painstaking examination of the administrative record, we find that we must set Order No. 1052 aside and remand the case to the Commission for further proceedings.

In brief summary, our review discloses that in its analysis of Transit's presentation underlying allowance of the increases the Commission mishandled three factors bearing vitally on the propriety of raising the fares. The first of these is the appreciation in market value of certain parcels of unimproved real estate which occurred while they were employed in Transit's operations. The second factor is the efficiency of Transit's service, as to which an investigation is prerequisite to setting higher fares. The final

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*Sitting by designation pursuant to 28 U.S.C. § 293(a) (1970).

[1] *D.C. Transit Sys., Inc.* (Order No. 1052), 85 P.U.R.3d 1 (WMATC 1970).

[2] Other aspects of Order No. 1052 came under review by the court in *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, 146 U.S.App.D.C. 392, 452 F.2d 1321 (1971), and the order was affirmed in the particulars reviewed therein.

factor is the concept of reasonable rate of return which should have guided the Commission in its fare determinations. We conclude that the Commission did not adequately take into account the first two factors and labored under a misunderstanding of the third.

Our opinion is divided into five parts. Part I recites the history and content of Order No. 1052 and the evolution of this litigation. Part II defines the role which value-appreciation of properties in operating status should have played in the fare-setting process under review. Part III concerns the need, which the Commission should have sufficiently met, to evaluate the efficiency of Transit's service in resolving its claim for increased fares. Part IV discusses the concept of reasonable return on a utility's investment as that concept is elucidated in *Market Street Railway Company* v. *Railroad Commission*[3] and as the Commission should have applied it when fashioning Order No. 1052. The concluding section, Part V, summarizes our holdings and our directions to the Commission for remedying these defects on remand.

I. BACKGROUND OF THE LITIGATION

On March 13, 1970, Transit filed new tariffs and an application with the Commission seeking authority to raise certain of its fares for transportation of passengers within the District of Columbia and between the District and points in nearby Maryland and Virginia.[4] In the main,

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[3] 324 U.S. 548 (1945).

[4] See Franchise Act § 7, 70 Stat. 598 (1956); Washington Metropolitan Area Transit Regulation Compact, tit. II, art. XII, §§ 5(a), 6(a) (Transit Regulation Compact), incorporated into Pub.L. No. 86-794, 74 Stat. 1031 (1960), with amendments, appearing as part of Pub.L. No. 87-767, 74 Stat. 765 (1962), set forth following D.C. Code § 1-1410a (1967). Title II of the Transit Regulation Compact is the

the application requested an increase in the basic District of Columbia and Maryland fares from 32 cents to 40 cents and increments to the Maryland zone fares.[5] In addition to this application, Transit filed a motion for an interim increase in the basic District of Columbia and Maryland fares to 35 cents and slight interim increases in the Maryland zone fares. Transit urged an interim order as a means of lessening its alleged financial difficulties[6] at a date earlier than expiration of the 150-day period legislatively specified and traditionally necessary for processing new fare applications.[7]

Because, in its view, the request for interim relief presented issues essentially identical with and as deserving of public comment as those inherent in the regular application, the Commission decided that the better procedure

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Washington Metropolitan Area Transit Authority Compact (Transit Authority Compact), which is incorporated into Pub.L. No. 89-774, 80 Stat. 1324 (1966), and is set forth following D.C. Code § 1-1431 (1967). In this opinion we refer to the Transit Regulation Compact and the Transit Authority Compact together as the "Compact." See also *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, —— U.S.App.D.C. ——, ——, 466 F.2d 394, 404-05, *cert. denied*, 409 U.S. 1086 (1972).

[5] The requested increases are listed in full in Order No. 1052, *supra* note 1, 85 P.U.R.3d at 4-5.

[6] Transit contended that the interim fare increase was necessary to meet a shortage in operating funds, a critical situation which was intensified by the growing insufficiency of existing fares to cover day-to-day expenses.

[7] See Compact, *supra* note 4, tit. II, art. XII, §§ 5(e), 6(a). See also *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, No. 22,450 (D.C. Cir. June 28, 1973), at 2-6; *Payne* v. *Washington Metropolitan Area Transit Comm'n*, 134 U.S.App.D.C. 321, 323 n.3, 415 F.2d 901, 903 n.3 (1968).

would be to consider the regular application on an expedited basis,[8] deferring action on the interim motion to such point in the proceedings at which it might become unavoidably required.[9] Accordingly, and pursuant to the Washington Metropolitan Area Transit Regulation Compact,[10] the Commission suspended Transit's proposed fares [11] and ordered public hearings.[12]

After completion of the hearings, the Commission promulgated Order No. 1052. It found that in the historical twelve-month period immediately preceding November 30, 1969,[13] Transit had a net operating income, after

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[8] *D.C. Transit Sys., Inc.* (Order No. 1031) (WMATC Mar. 26, 1970) (unreported).

[9] *Id.* The Commission was later to observe that a public hearing on the interim request would have required "due notice to the public," "an adequate period for preparation and presentation of rebuttal evidence," and "time for us to deliberate on the questions presented." *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 5. As it turned out, the Commission did not reach the point at which it felt a need for an interim order.

[10] See note 4, *supra*.

[11] In accordance with the Compact, *supra* note 4, tit. II, art. XII, § 6(a)(1), Transit's proposed tariffs were suspended on March 26, 1970. *D.C. Transit Sys., Inc.* (Order No. 1031), *supra* note 8. A further suspension was made on April 10, to terminate no later than July 10. *D.C. Transit Sys., Inc.* (Order No. 1035) (WMATC Apr. 10, 1970) (unreported).

[12] *D.C. Transit Sys., Inc.* (Order No. 1031), *supra* note 8.

[13] The twelve-month period ending November 30, 1969, was used as the historical year furnishing the data on which forecasts for the future annual period were based. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R. 3d at 6.

adjustments to operating revenue,[14] of $862,005 which, however, when offset by interest charges of $1,293,651, was transformed into a net loss of $431,646[15] and a reduction of retained earnings to $1,241,203.58.[16] The Commission's conclusion that Transit's fares were too low was reached by a series of estimates. It reasoned that if the basic District of Columbia and Maryland fares were maintained at 32 cents, if loss of ridership continued at the rate anticipated by Transit officials,[17] if the Commission staff's pro-

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[14] The Commission disallowed an unsupported office expense of $6,220.38 and a $10,000 legal fee for non-transit services. *Id.* at 6 n.1. Total reductions in operating expenses were $24,295.67. *Id.* at 6.

[15] *Id.* at 6.

[16] *Id.*

[17] The Commission customarily gives attention, in forecasting future revenues under raised-fare structures based on past ridership records, to the public's resistance to fare increases. To calculate the ridership figures projected in the instant proceeding, the Commissioned examined the actual ridership figures for the seven months preceding October, 1969, when Transit had received its last fare increase, and added thereto the actual ridership figures for the five months following that increase; and to determine the impact of the October, 1969, elevation in fares the Commission applied a .32% resistance factor to those figures. *Id.* at 7. In previous ratemaking proceedings the resistance factor had been estimated at .20% for each 1% increase in fares; in this proceeding the resistance factor was carried upward to .32% for each 1% increase in fares. *Id.* Since the Commission reached a loss-of-ridership figure higher than that calculated by Transit, it chose to accept Transit's figure, reasoning that Transit bore the burden of proving its entitlement to relief and hence the Commission would not ask the public to pay for something that Transit had not asked for. *Id.* at 8. See *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 2, 146 U.S.App.D.C. at 394-95, 452 F.2d at 1323-24.

jection of income from charter revenues were accepted,[18] if the sum expected by Transit from school subsidies were likewise accepted,[19] if the company's reserve for injuries and damages were increased from $1.3 million to $1.9 million,[20] if maintenance costs were adjusted upward by another half-million,[21] if profits of $620,000 were channeled to bus purchases,[22] if management salaries were reduced by $15,000,[23] and if deduction of $526,177.03 for track re-

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[18] By annualizing Transit's revenues from charter operations during the three most recent quarters, the Commission arrived at a higher revenue figure than that offered by Transit. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 8-9. See also *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 2, 146 U.S.App.D.C. at 396, 452 F.2d at 1325.

[19] Transit's figure of $1,868,633 was accepted over the Commission's figure of $1,772,709 because the company had utilized more current data. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 8.

[20] See also *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 2, 146 U.S.App. D.C. at 395-96, 452 F.2d at 1324-25. To insure that monies to accommodate claims for injuries and damages would be available, the Commission required that 70% of the $1.9 million allowed as an expense be funded at the rate of $110,833 per month. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 11.

[21] Transit requested an additional $474,073 and the Commission allowed $517,200, to be placed in escrow pending expenditure for the purpose intended. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 11-12. The difference is explained by payroll fringe costs. *Id.* at 12.

[22] This would enable resumption of a bus-purchase program which had been temporarily suspended in *D.C. Transit Sys., Inc.* (Order No. 984), 81 P.U.R.3d 417, 454 (WMATC 1969).

[23] Salary increases of $5,000 to each of three senior officers were disallowed. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 13 n.6.

moval expenses were made,[24] Transit would during the ensuing twelve months lose $2,676,115 which, after inclusion of interest charges, would build up to $3,974,990. "These facts," the Commission declared, "make adjustments in the fares not only necessary, but imperative. . . ." [25]

The Commission then turned to the question of the fares to be allowed. It found that if the fares proposed by Transit were inaugurated, they would generate net operating income of $2,440,284.[26] Interest expenses of $1,198,875 were projected, to which the Commission added new interest charges of $234,263 incidental to bus purchases and $100,000 to meet interest payments on a $1 million loan acquired to settle Transit's debt to its employees' pension fund.[27] After payment of the aggregate interest cost of $1,533,138, then, there would be a dollar return of $907,146, or a return on equity of 52.10 percent; [28] and with the required purchase of 85 buses, the rate of return on operating revenue would be 7 percent, an operating ratio of 107 percent.[29] Since the

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[24] The District of Columbia Department of Highways and Traffic estimated what the expenses would be during the future annual period. *Id.* at 13-14. The Commission believed that this cost should be borne by the community at large rather than by the riders, but included it as a cost of service since it was improbable that Congress would assume it. *Id.* at 14.

[25] *Id.* So, although particular items of expense and revenue were disputed, both the Commission and Transit agreed that Transit would not receive sufficient revenues under the existing fares even to cover operating expenses. *Id.*

[26] *Id.* at 16.

[27] *Id.*

[28] *Id.* at 16-17.

[29] *Id.* at 15.

rate of return had been thoroughly discussed at two recent fare proceedings,[30] the Commission considered that new testimony thereon was unnecessary, so instead it stipulated that official notice of all rate-of-return testimony in those proceedings would be taken.[31]

The Commission noted that the projected return would theoretically permit payment of a dividend which would probably attract investors, but admonished that, given the record of operating losses which Transit had incurred in past years, it would be imprudent to distribute any of the return to Transit's investors.[32] It was the Commission's expectation, rather, "that the cash flow represented by return on equity would, for the time being, be used in the company's financial recovery, rather than for the payment of dividends."[33] This return, the Commission felt, would provide the internally-generated capital needed to meet down payments on new buses, improve Transit's credit—thereby facilitating other purchases of new equipment—and aid in settling some of Transit's current liabilities of more than $10 million.[34] In the opinion of the Commission, the return allowed would thus contribute to the company's recovery without imposing an undue burden on the fare-

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[30] *D.C. Transit Sys., Inc.* (Order No. 880) (WMATC Oct. 18, 1968) (unreported), at 23-36; *D.C. Transit Sys., Inc.* (Order No. 984), *supra* note 22, 81 P.U.R.3d at 428-34.

[31] *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 15.

[32] *Id.* at 16. Transit is the wholly-owned subsidiary of another corporation, but we refer throughout this opinion to Transit's "investors" for the sake of convenience in discussing the relevant ratemaking principles.

[33] *Id.*

[34] *Id.* at 15-17.

paying public.[35] The increases, the Commission thought, would be sufficient to offset reduction in ridership which the company may not have adequately taken into account,[36] and to permit the inauguration of reduced fares in off-peak hours for senior citizens.[37]

By the Commission's estimate, the new fare structure would produce an abnormally high return on equity of 52.10 percent.[38] Adverting to that fact, the Commission observed:

> This figure must be carefully assessed. The losses incurred by the company in recent years have reduced retained earnings from $2,890,848 in 1966 to $1,241,204 as of November 30, 1969. Were it not for special adjustments to retained earnings in the net amount of $605,008 during the past three years, the balance in retained earnings account would have stood at $636,196.
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> We believe that this factor must be heavily weighed in considering the significance of the percentage return on equity. In these circumstances, the percentage return is an unreliable indicator of adequacy. The central fact is that the dollar return which is our target has remained essentially the same for several years. Circumstances have prevented the company from earning that return, with a consequent effect on the level of retained earnings. We believe that the factors which made the dollar level appropriate at a time when those dollars meant 38.54 per cent return on equity are equally valid today. Thus, since we are allowing a dollar return on equity which is only slightly higher than the levels we have found to be reasonable in other recent orders, and since we think

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[35] *Id.*

[36] See note 20, *supra.*

[37] *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 17.

[38] *Id.*

> that there are sound reasons for that slight extra allowance in this proceeding, we do not regard the percentage return on equity which that dollar return now represents as being an obstacle to our allowance here.[39]

The Commission did, to some extent at least, take into consideration alternatives to raising the fares. One such alternative was the possibility of cost reductions through service cutbacks. Testimony adduced at the hearings indicated that to offset the increase which the Commission felt necessary, a service cutback of approximately 16 percent would be required, and that, the Commission said, "would mean tremendous reductions in service."[40] The alternative most attractive to Commission members—a federal appropriation—was deemed most unlikely in view of the fact that Congress traditionally linked federal non-school subsidies for transit in the District of Columbia to public ownership of the transit operation.[41] In any event, the Commission believed that it was without power to stay the fare raises until such time as legislation for public acquisition might be enacted. "Both the Compact and the case law," said the Commission, "require us to supply sufficient revenues so that the Company can recover its expenses and have an adequate return."[42] And, the Commission added, "[w]e think that subjecting the community to the reality, or even the substantial risk, of a cessation of service would not be in the public interest, even for a laudable goal of achieving legislation which would alleviate the problem of rising fares."[43] Thus, although, as the

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[39] *Id.* at 17-18.

[40] *Id.* at 26-27.

[41] *Id.* at 26.

[42] *Id.* at 25-26.

[43] *Id.* at 26.

Commission recognized, a 25 percent increase in the basic fares would impose a tremendous hardship upon the poor, the Commission reasoned that the public interest would be ill-served by fares which threatened to put a stop to transit service altogether.[44]

Order No. 1052 authorizing the increases was released on June 26, 1970, and was scheduled to take effect at 12:01 a.m. on June 28.[45] On June 27, however, we stayed operation of the order pending disposition by the Commission of applications for reconsideration tendered by petitioners.[46] On July 1, 1970, the Commission issued Order No. 1057 by which it denied reconsideration for the asserted reason that no new grounds warranting a different order were advanced.[47] The Commission opined that all ramifications of relevant public interest had already been adequately examined as required by Section 6(a)(3) of the Compact.[48] Those considerations were not reflected dollar-wise,

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[44] *Id.*

[45] The fare changes authorized by Order No. 1052 are omitted from the published report. *Id.* at 29. They do appear in the record before us. Proposed increases were allowed for token cost, interline fare, D.C. Stadium fare and Capitol Hill express fare—all in the District of Columbia—and in the Virginia interstate zone fare. Proposed increases were modified and allowed for Maryland zone fares, District of Columbia-Maryland interstate local fares, and District of Columbia-Maryland interstate express fares. A proposed increase for the minibus fare was disallowed. See *D.C. Transit Sys., Inc. v. Washington Metropolitan Area Transit Comm'n*, *supra* note 2, 146 U.S.App.D.C. at 396, 452 F.2d at 1325.

[46] *Black United Front* v. *Washington Metropolitan Area Transit Comm'n*, 141 U.S.App.D.C. 73, 79, 436 F.2d 227, 233 (1970).

[47] *D.C. Transit Sys., Inc.* (Order No. 1057), 85 P.U.R.3d 33 (WMATC 1970).

[48] Compact, *supra* note 4, tit. II, art. XII, § 6(a)(3), quoted in text *infra* at note 129.

however, in the final determination because the Commission believed that when Section 6(a)(3) was read in conjunction with Section 6(a)(4),[49] Transit was entitled to a tariff structure which would enable it to meet its expenses and provide a fair return to its investors.[50] The Commission felt that since the record contained no facts suggesting that Transit's management was inefficient or dishonest, a diminished return was not justified on a theory of uneconomical operation.[51] In the Commission's view, the rate of return which it had approved was fair and roughly equivalent, despite its exceedingly high percentage of investors' equity,[52] to margins of profit allowed and held lawful in previous fare cases.[53] Further delay in instituting the new fares pending the outcome of further litigation was rejected as directly contrary to the Compact's proscription of administrative suspensions of fare tariffs for a period of more than 150 days.[54] The Commission reiter-

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[49] The Compact, *supra* note 4, provides at tit. II, art. XII § 6(a)(4):

> It is hereby declared as a matter of legislative policy that in order to assure the Metropolitan District of an adequate transportation system operating as private enterprises the carriers therein, in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors. As an incident thereto, the opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

[50] *D.C. Transit Sys., Inc.* (Order No. 1057), *supra* note 47, 85 P.U.R.3d at 38-39.

[51] *Id.* at 37.

[52] *Id.* at 39-40.

[53] *Id.*

[54] *Id.* at 41.

ated that in Order No. 1052, as in previous orders, it had recognized the socio-economic hardship which a fare increase would precipitate, but that, absent congressional action, revenues would have to be produced through larger fares in order to offset Transit's rising expenses, including particularly its growing labor costs.[55] The effective date of Order No. 1052 was reset—July 11, 1970, at 12:01 a.m.—and subsequent petitions for reconsideration were denied.[56]

Upon the filing of the petitions in this court, petitioners moved for a stay of Order No. 1052 pending judicial review. On balance of the competing considerations in light of the criteria guiding action on such applications, that motion was denied on July 10, 1970.[57] Now, of course, Order No. 1052 is before us for a full examination on the merits, and to that task we proceed.

II. APPRECIATION IN LAND VALUES

A major contention advanced by some petitioners,[58] similar to the one tendered in *Democratic Central Committee* v. *Washington Metropolitan Area Transit Commission*,[59] decided today, is that in passing on Transit's ap-

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[55] *Id.* at 37, 42.

[56] *D.C. Transit Sys., Inc.* (Order No. 1062) (WMATC July 8, 1970) (unreported); *D.C. Transit Sys., Inc.* (Order No. 1066) (WMATC July 13, 1970) (unreported); *D.C. Transit Sys., Inc.* (Order No. 1067) (WMATC July 14, 1970) (unreported); *D.C. Transit Sys., Inc.* (Order No. 1074) (WMATC July 24, 1970) (unreported); *D.C. Transit Sys., Inc.* (Order No. 1090), 85 P.U.R.3d 508 (WMATC 1970).

[57] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, 141 U.S.App.D.C. 79, 83, 436 F.2d 233, 237 (1970).

[58] Petitioners in Nos. 24,398 and 24,428.

[59] No. 21,865 (D.C. Cir. June 28, 1973).

plication for higher fares, the Commission should have considered the appreciation in the value of certain of Transit's landholdings occurring while the lands were in service and prior to their transfer from operating to nonoperating status. A related contention [60] is that in revising Transit's fares, the Commission improperly ignored income which Transit had received from its subsidiaries, to some of which certain of the nonoperating properties had been conveyed.[61] The Commission and Transit vigorously oppose both arguments on the merits. Transit urges additionally that neither argument was made to the Commission as a ground for reconsidering Order No. 1052, and that for that reason neither can now be made a subject of judicial review.[62] We examine first the jurisdictional challenge.

A. *Jurisdiction to Consider*

By the terms of the Compact,[63] anyone affected by a final Commission order may seek its reconsideration, in whole or in part.[64] This can be done by "an application in writing requesting a reconsideration of the matters involved, and stating specifically the errors claimed as grounds for

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[60] Presented only by petitioner in No. 24,428.

[61] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at app.

[62] See note 64, *infra*.

[63] *Supra* note 4.

[64] "Any person affected by any final order or decision of the Commission may, within thirty days after the publication thereof, file with the Commission an application in writing requesting a reconsideration of the matters involved, and stating specifically the errors claimed as grounds for such reconsideration. No person shall in any court urge or rely on any ground not so set forth in such application." Compact, *supra* note 4, tit. II, art. XII, § 16.

such reconsideration." [65] The Compact expressly provides, however, that "[n]o person shall in any court urge or rely on any ground not so set forth in such application." [66] Only recently we had occasion to advert to these provisions and the policy underlying them,[67] and even today we have occasion to apply them.[68] It is Transit's position that both of the aforesaid contentions are thus intercepted.

Following the issuance of Order No. 1052, each of the petitioners presented to the Commission one or more applications for reconsideration. Only one,[69] however, in any way mentioned land transfers as a ground for disturbing the order. That was a request that the Commission vacate Order No. 1052 and postpone further consideration of a fare increase until final determination by this court, in *Democratic Central Committee*,[70] of the credit properly to be allowed bus riders for the appreciation in value of Transit's "land" withdrawn from public use.

While, to be sure, this assignment of error might have been drawn more artfully, we deem it sufficient to preserve the point for judicial review. It sets forth, though succinctly, the kernel of the complaint, and the reference to *Democratic Central Committee*, then fully briefed and

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[65] See note 64, *supra*.

[66] See note 64, *supra*.

[67] *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 413-14.

[68] *Powell* v. *Washington Metropolitan Area Transit Comm'n*, No. 21,750 (D.C. Cir. June 28, 1973), 12, at nn.39-41.

[69] Petitioner in No. 24,398.

[70] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59.

awaiting oral argument in this court, makes the scope and content of the complaint unmistakable. For, as today's opinion in that case discloses, the only viable issue there is the allocation, as between Transit's investors and its farepayers, of the appreciation in value of properties while used in its operations.[71] The Commission does not suggest that it misunderstood the thrust of this assignment,[72] nor do we see how it could.[73] We conclude that the issue of participation by Transit's consumers in value-appreciation of transferred land[74] is properly presented for review.[75]

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[71] See *id.* at ——. See also note 74, *infra.*

[72] The Commission poses no objection whatsoever to consideration of the value-appreciation issue on this review.

[73] In *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, we pointed out that the principal consideration underlying the requirement that issues first be presented for Commission reconsideration "is the opportunity, through precise identification of the errors alleged, for administrative reexamination and correction prior to judicial intervention in the regulatory process." —— U.S. App.D.C. at ——, 466 F.2d at 413 (footnote omitted).

[74] The only question of value-appreciation raised for Commission reconsideration or briefed here pertains to *land.* The issue before us here is accordingly so limited. See text *supra* at notes 69-71. See also *Powell* v. *Washington Metropolitan Area Transit Comm'n, supra* note 68, at 12-13; *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at ——; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at 3-6, 466 F.2d at 413-14. It is thus narrower than the issue in *Democratic Central Committee,* which extends to depreciable as well as nondepreciable property.

[75] Compare *Williams* v. *Washington Metropolitan Area Transit Comm'n,* 134 U.S.App.D.C. 342, 374 n.181, 415 F.2d 922, 954 n.181 (*en banc* 1968), *cert. denied,* 393 U.S. 1081 (1969).

Transit's other position—as to the propriety of our review of the Commission's failure to include income from its subsidiaries in its computation of the new fares—rests, however, on solid ground. Nowhere in the several applications for Commission reconsideration in the record before us are we able to discern anything "stating specifically"[76] —or otherwise—that particular objection as a basis for reexamining Order No. 1052. Indeed, none of the petitioners has even responded to Transit's argument that the issue of income from subsidiaries cannot now be raised here. For the omission of a step essential to our jurisdiction, we hold that that issue is not open on this review.[77]

B. *The Issue on the Merits*

Having confirmed our jurisdiction to review the question of allocation of the in-service value-appreciation in lands withdrawn from operations by Transit, we proceed to deal with the issue on the merits. In considering *Bebchick* v. *Washington Metropolitan Area Transit Commission*[78] and *Democratic Central Committee* v. *Washington Metropolitan Area Transit Commission*,[79] both decided today, we pointed out that Transit has, since 1956, transferred cer-

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[76] No explanation for not presenting the point to the Commission being offered, we do not confront the question whether the Compact requirement, see note 64, *supra*, relaxes in extraordinary circumstances.

[77] See *Powell* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 68, at 12-13; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 413-14. See also *FPC* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 501 (1955); *Granite City* v. *Illinois Commerce Comm'n*, 407 Ill. 245, 95 N.E.2d 371, 374 (1950).

[78] No. 23,720 (D.C. Cir. June 28, 1973).

[79] *Supra* note 59.

tain properties, which it had acquired from its predecessor, out of operating status—"below the line," in the convenient shorthand expression [80]—and we hold in *Bebchick* that, at least for the depreciable part of those withdrawn assets, the difference in value between the book figure at which the items were transferred and their fair market value at the time of transfer should be considered reimbursement to Transit's investors for the depreciation deficiency with which *Bebchick* was concerned.[81] In *Democratic Central Committee,* we treat both the depreciable and the nondepreciable portions of the transferred assets, and conclude that gains from the appreciation in value of either should have been credited to Transit's farepayers [82] —except, of course, for those gains which *Bebchick* requires as compensation to Transit's investors for the aforementioned depreciation deficiency.[83]

As we have said, the issue in the present cases can extend no further than value-appreciation of land,[84] and the extent to which in-service appreciation of Transit's below-the-line lands may be depleted by the response to today's holding in *Democratic Central Committee* cannot be pinpointed at the moment. But since we cannot assume that proper handling of the problem in *Democratic Central Committee,* when that litigation was before the Commis-

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[80] See *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at app., for a list of the transferred properties.

[81] *Bebchick* v. *Washington Metropolitan Area Transit Comm'n, supra* note 78, at 36-37.

[82] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 73-74.

[83] See *Bebchick* v. *Washington Metropolitan Area Transit Comm'n, supra* note 78, at 45.

[84] See note 74, *supra,* and accompanying text.

sion, would have completely exhausted the in-service appreciation of Transit's lands now held below the line, it is appropriate to inquire, at the instance of some of the petitioners, whether Order No. 1052 is invalid for failure to take the residue of such appreciation into account.

There can be no doubt as to the answer to that question. The discussion in *Democratic Central Committee* and its amplification in *Bebchick* make plain the Commission's obligation to consider appreciation-allocation when it undertook to revise transit fares. In the proceeding under review, we have held that this responsibility, as respects land appreciation, was suitably invoked,[85] but it is evident that in no way was it discharged. Indeed, nowhere in Order No. 1052 nor in any of the several orders denying its reconsideration is the problem even mentioned. We hold, then, that as a result of this omission, Order No. 1052 is fatally defective.[86]

In lieu of another discourse on the problem here, it suffices to refer our readers to the comprehensive treatment in *Democratic Central Committee*. Made here, however, are additional arguments by which Transit and the Commission endeavor to support this aspect of Order No. 1052, and we will comment specifically on these. What follows is some elaboration on points encompassed within the much broader discussion in *Democratic Central Committee*.

The Commission's position has continued to be that an increase in the value of nondepreciable property—land in this instance—dropped below the line belongs entirely to investors, and that consumers have no right to that gain or

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[85] See text *supra* at notes 69-75.

[86] We deal with the consequences of this holding in Part V, *infra*.

any share in it.[87] We reiterate our assertion in *Democratic Central Committee* that we find no basis in regulatory law or logic for this absolute principle, to which the Commission mechanically adheres.[88] The agency's theory is that, since the farepayers did not contribute to the cost of such property through absorption of depreciation charges, they ought not to participate in any profit, which should go solely to the investors, who alone have borne the capital cost of the asset.[89] The Commission stresses, too, that if there had been a decrease in the value of this real estate, the consumers would not have borne any part of the loss, nor would they have been expected to, under the accounting system followed by the Commission.[90] Whatever may be the merit of that overall position in other circumstances, for other pieces of property or for other companies, there are a number of reasons—some articulated in *Democratic Central Committee*[91] and some here—why we do not think it is appropriate for this utility and for the particular assets we are now considering.

To begin with, we do not share the Commission's theory that simply by virtue of having paid the cost of an asset, Transit's investors are automatically entitled to the gain in its market value. As we point out in *Democratic Central Committee,* this correlation between ownership of the asset and entitlement to its value-appreciation has faded with the demise of fair value as the standard for setting either a rate or a depreciation base.[92] The viable concept

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[87] See also *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 22-26, 66.

[88] *Id.* at 25-26, 70-71.

[89] Compare *id.* at 22-26.

[90] But see *id.* at 51.

[91] *Id.* at pt. IV(B).

[92] *Id.* at pt. III.

today is that "the investor's legally protected interest resides in the capital he invests in the utility rather than in the items of property which that capital purchases for provision of utility service." [93] That thesis refutes the notion that investors inexorably become entitled to appreciation in value of operating assets as inseparable and inviolable incidents of their investments.[94]

The investment-in-capital concept has particular relevance to Transit's circumstances in view of the fact that these were not properties added to the existing transportation system in the District of Columbia by Transit out of its own assets or acquisitions. Rather, Transit acquired them, as integral parts of the District's transit system, in 1956 from Capital Transit Company at the time the former received the franchise.[95] Thus, it is evident that we are not dealing with the same kind of situation, as the Commission seemingly supposed, that would have existed had the properties been originally purchased outright by Transit's investors with a view to deployment as they pleased. What the investors bought was an ongoing mass-transportation system with physical components, including the lands in question, long since dedicated to public service. We do not mean to imply that had that not been the case, value-appreciations would necessarily have been immune to claims of farepayers. We do say that since that was the case, it makes those appreciations more susceptible to those claims.

When it gave Transit the franchise, Congress knew that these properties were being taken over from the prede-

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[93] *Id.* at 30.

[94] *Id.* at 31-32.

[95] The history of Transit's acquisition of Capital's assets is detailed in *id.* at 51-56.

cessor operator,[96] and Congress also knew that Transit paid Capital some $10 million less than the net original cost to Capital—some $10 million less than the book value at which these items were transferred below the line Congress knew, too—because that was a requirement of the franchise—that Transit would have to convert from a bus-and-trolley operation to an all-bus system,[97] and that a good part of these same properties would, as a consequence, no longer be needed for transportation purposes. And Congress must have known—this was common knowledge—that there was no real possibility that the value of these pieces of land would decline below book value.[98] On the contrary, the known fact was that they had already increased in worth, and the very high probability was that they would continue to do so, or at least would not suddenly decline below the 1956 book value.

Nothing in the Franchise Act[99] nor its historical context, then, suggests that Congress intended that Transit's

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[96] Franchise Act, Pub.L. No. 757, 70 Stat. 598, 604 (1956), tit. II, §§ 201(a), 202, 203. See also H.R. Rep. No. 2751, 84th Cong., 2d Sess. 11, 17 (1956).

[97] Franchise Act, Pub.L. No. 757, 70 Stat. 598, 599 (1956), tit. I, pt. 1, § 7. For a more detailed discussion of the conversion requirement, see *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at 52-56.

[98] As the Commission tells us,

> . . . by any realistic view of the actual situation at Transit, its real estate holdings will not decrease in value below original cost, *nor was there ever any risk that they would do so.*

Brief for Respondent at 13, *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59 (emphasis added). And see the discussion in that case at 52-56.

[99] Pub.L. No. 757, 70 Stat. 598 (1956).

investors would automatically pocket, at the expense of the farepayers, the expectable increment in value which had and would come to properties forming an integral part of the existing transit system in 1956, and which would necessarily and shortly become nonoperating in large part as a result of the mandatory dropping of the trolley service. Under such conditions, we cannot believe that Congress contemplated such an outright gift to Transit's investors, who would not have done anything to earn or deserve it, nor would they have borne any risk of loss on those pieces of land. It is not sensible to suppose that a Congress intent on fair terms for the farepayer contemplated such a bonzana. Congress did give certain advantages to Transit—with respect to taxes, for instance [100]—but we cannot see that an automatic right to this increase was one of them. On the contrary, we think it rather obvious that as to these properties the Commission was left the responsibility of determining what should properly be done with the increase in value, and that it could not mechanically or rigidly follow some assumed general rule plainly inappropriate to these specific circumstances.

It is said, however, that it would be unfair to Transit to force it to share or to pass on this gain when it could not, under the Commission's system of accounts, receive reimbursement from the riding public for a decrease in the value of the properties. We are not nearly so confident that utility investors cannot recoup capital losses on nondepreciable assets where they are actually sustained,[101] but we need not debate the point. For, as we have pointed out,[102] the consideration that the lands in question might

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[100] See *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 60 n.273.

[101] See *id.* at 73.

[102] See text *supra* at note 98.

have fallen in value during the period of Transit's franchise is wholly illusory. From the beginning, there was never any real risk of such a loss to Transit, only the probability of a profit. In that situation, it cannot be the law that Transit's right to retain the profit flows from the absence of formal inclusion by the Commission in its uniform system of accounts of a provision that the farepayers would bear or share in such a loss—that the consumers would be entitled if the accounting system so provided, but not if such a clause were omitted. Since the inclusion or non-inclusion of that provision would in all events be wholly academic and non-operative for these particular properties, to make the issue turn on that technical point would be in effect to give the Commission *carte blanche* arbitrarily to hand over the gain to Transit, or to deny it in advance, without consideration of the substantive merits or demerits of what it was doing.[103] There being no real possibility of loss, the Commission could not justly say, if it omitted a provision for the consumers to carry the loss, that the company was entitled to the gain because it alone shouldered the nonexistent risk of loss. Conversely, if the agency did happen to incorporate such a provision in its system of accounts, it could not justly say that because of that fact alone, the consumers should receive the profits because they would bear the nonexistent risk of loss. With respect to these specific properties, because of the special circumstances to which we have referred, no proper judgment could be made on that unrealistic basis.

In *Democratic Central Committee*,[104] we discuss at some length the principle—applied in that case—that benefit should follow burden, and gain should follow risk of loss.[105]

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[103] See *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at 66-71.

[104] *Supra* note 59.

[105] *Id.* at 40-50.

But the foregoing discussion here illustrates the limits to that principle where, as a practical fact of the matter, there is no risk of loss. What the Commission was called upon to do here, and what it utterly failed to do, was to exercise its judgment instead of blindly applying a rule inappropriate to the situation presented. The only sound foundation for such a judgment, we think, is to look to see whether it would be fair, in the total situation, to save this gain wholly for the investors—and, if not, what proportion should be passed on to the farepayers, and in what form and at what time.[106] In other words, the problem was one for the exercise of informed reason and discretion on the specific and individual facts and circumstances.[107] This court has taken this approach in similar cases,[108] and there is no good reason for failing to utilize it here.

We may briefly consider three other objections to rejecting the rule that investors are automatically entitled to retain all the gain on the land transferred out of operations. The first is that investors had the right to believe that they would be able to keep these profits, and that it is unjust now to act against that assumption. We think, however, that no such belief was warranted. As we have said, the Franchise Act, correctly interpreted, gives no foundation for that belief with respect to these properties.[109]

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[106] See *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 71-74.

[107] *Id.* at 71.

[108] See, *e.g., D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n,* 121 U.S.App.D.C. 375, 397-98, 350 F.2d 753, 775-76 (*en banc* 1965); *D.C. Transit Sys., Inc.* v. *Public Utils. Comm'n,* 110 U.S.App.D.C. 241, 242, 292 F.2d 734, 735 (1961); *Washington Gas Light Co.* v. *Baker,* 88 U.S.App.D.C. 115, 118-19, 188 F.2d 11, 14-15, *cert. denied,* 340 U.S. 952 (1950).

[109] See text *supra* at notes 99-100.

Insofar as there may be a rule of thumb allocating to the investors both gain or loss on such nondepreciable assets, there is no showing that such a rule has been mechanically applied where, as here, there is no risk of loss at all but only of gain.[110] Even the course of regulation by this Commission and its predecessor would not give adequate footing for the assumption. Though it dealt with different facets of the same general problem, our opinion in *Washington Gas Light Company* v. *Baker*,[111] decided in 1950 before Transit received its franchise, alerted all those concerned with utility regulation in the District of Columbia that the realities of the particular situation would govern, not formal rules or principles applied in a vacuum.[112] That was also the attitudes of the regulatory agencies and of this court in other cases.[113]

Acting on that very basis, this Commission in 1966 adopted Regulation 61 treating of gain on depreciable property put below the line and discussed in detail in our opinion in *Bebchick*.[114] That regulation provides that when depreciable property is transferred below the line, the company must file a fair market valuation of the property, and the excess of fair market value, determined by appraisal, over the unrecovered cost must be deducted from the depreciation expense in the transfer years, so that the

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[110] See the discussion in *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 17-26, 40-44, 51.

[111] *Supra* note 108.

[112] *Id.* at 118-19, 188 F.2d at 14-15.

[113] See *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 108, 121 U.S.App.D.C. at 397-98, 350 F.2d at 775-76; *D.C. Transit Sys., Inc.* v. *Public Utils. Comm'n, supra* note 108, 110 U.S.App.D.C. at 242, 292 F.2d at 735.

[114] *Supra* note 78, at 27-31.

farepayers will receive the benefit of the increase in value.[115] We are not advised of any prior rule or regulation of the Commission or its predecessor agency governing specifically the allocation of property value appreciations as between investors and consumers.[116] There was no such promise, then, in 1956, or at the time these properties were put below the line, that gain on land placed in nonoperating status would go automatically to the investors.

Next there is the argument, also discussed in *Bebchick*, that nothing can possibly be done about the gain until there is an actual sale or disposition. Aside from the fact that the properties in question have now been disposed of, albeit involuntarily,[117] most of the reasons given in *Bebchick* for turning down that unqualified position [118] likewise apply with equal force here. In particular, the same grounds which moved the Commission to adopt Regulation 61 for depreciable property pertain as well to these below-the-line land properties. Though the Commission might, on a proper showing, have decided that this gain in land value should not be utilized for ratemaking purposes until it was actually realized by the investors, the agency could not refuse, simply because of lack of reali-

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[115] *Id.* at 28 n.112.

[116] See *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at 66-68.

[117] Pursuant to the National Capital Area Transit Act of 1972, Pub.L. No. 92-517, 86 Stat. 999 (1972), the company's transportation operations and operating assets were taken over by the Washington Metropolitan Area Transit Authority on January 14, 1973. The purchase price is being determined in condemnation proceedings initiated by the Transit Authority. See *id.* at 86-88.

[118] See *Bebchick* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 78, at 31-33.

:ation, to consider the possibility of using the profit before that time.[119]

Finally, we do not think that it would be a denial of due process or of just compensation to require, in proper circumstances, that all or some of the gain from these properties be passed on to the riders, any more than Regulation 61 is unconstitutional with respect to depreciable property.[120] In the special situation in which these pieces of real estate were acquired by Transit in 1956, Congress could have said explicitly, when it granted the franchise, that gain accrued and accruing on them would not necessarily redound to the investors' benefit. That would certainly have been a reasonable legislative requirement,[121] and the fact that Congress did not state it does not make it any less reasonable.

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[119] We hold today in *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 74, that the value appreciations of depreciable and nondepreciable assets should there have been credited to busriders in fare-setting proceedings following the removal of those assets from operation *prior* to realization of any actual gain by Transit from their sale.

[120] The point on constitutionality is raised only by Transit.

[121] As we point out in No. 21,865, *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, with the end of the fair value standard for computing rate base and depreciation, it can no longer be argued that investors possess an inalienable claim to value appreciations accruing to in-service utility assets. *Id.* at Part II. The allocation of such gain must be resolved by balancing the respective risks, benefits and burdens of investors and consumers. *Id.* at notes 183-86. A careful study of the history of Transit's operating franchise demonstrates that an equitable balance here would pass that gain on to the riders. *Id.* at Part IV(B). Hence, a legislative determination that the increased value of these lands should not necessarily benefit Transit's stockholders would have been eminently reasonable.

In view of the special situation of these properties, we need not consider whether the same principle would control for other assets not acquired in comparable circumstances.

Resting as it does solely upon considerations we have rejected as reasons for holding that investors are entitled to all the gain on the transferred properties, the Commission has failed to address itself, under the correct standards, to the problem of how this gain should be used. Order No. 1052 is therefore invalid on this ground, in addition to others which we later discuss.[122] We hold today in *Democratic Central Committee* [123] that the appreciation in the value of Transit's assets—depreciable and nondepreciable—when moved into nonoperating status must be credited to the benefit of the bus riders.[124] Our holding in the cases at bar, though necessarily narrower,[125] adheres firmly to that decision. Moreover, since the Commission's failure to do that in formulating Order No. 1052 cannot be cured by retroactive ratemaking [126]—particularly in light of the recent public takeover of Transit [127]—it is left to implement the restitutionary remedy which we hereinafter describe more fully in our consideration of the disposition to be made.[128]

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[122] See Parts III-IV, *infra*.

[123] *Supra* note 59.

[124] *Id.* at 74.

[125] See note 74, *supra*.

[126] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at 76-77; *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 75, 134 U.S.App.D.C. at 360-61, 415 F.2d at 940-41.

[127] See note 117, *supra*.

[128] See Part V, *infra*.

III. EFFICIENCY OF MANAGEMENT

We turn now to the question whether the Commission adequately considered the level of efficiency of Transit's management in determining its right to the fare increase granted in Order No. 1052. All petitioners contend that the order must be set aside because the Commission did not follow the command of Section 6(a)(3) of the Compact, which provides:

> In the exercise of its power to prescribe just and reasonable fares and regulations and practices relating thereto, the Commission shall give due consideration, among other factors, to the inherent advantages of transportation by such carriers; to the effect of rates upon the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable such carriers, under honest, economical, and efficient management, to provide such service.[129]

In particular, petitioners say that the Commission failed to "give due consideration" to the efficiency of Transit's management. The Commission, and Transit, stand on what was said in its fare orders themselves. There the Commission refused to make any findings on efficiency, or to give it any weight in reaching its decision, because, it said, "neither [the Commission's] staff nor the protestants have presented facts indicating that the company's basic problems lie in adequate management."[130] We hold that in

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[129] Compact, *supra* note 4, tit. II, art. XII, § 6(a)(3).

[130] *D.C. Transit Sys., Inc.* (Order No. 1057), *supra* note 47, 85 P.U.R.3d at 37, denying reconsideration of *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1. There is no discussion in Order No. 1052 itself concerning efficiency or any of the Section 6(a)(3) factors. That is because, as the Com-

failing to investigate the caliber of the company's management on the ground that the formal parties had not produced evidence of bad management, the Commission violated the Compact. But since there is no need to do so, we do not decide whether this error, standing alone, would require setting aside Order No. 1052.[131]

Simply reading Section 6(a)(3) makes clear that in setting transit fares the Commission was obligated to consider, among other factors, the efficiency of the carrier's management. The criteria by which efficiency was to be measured, and the weight to be given it as a factor, lay, of course, within the judgment of the Commission in the first instance.[132] But the Compact required that efficiency be duly considered,[133] and the Commission obviously did not take

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mission explained, it had given its view of this problem in *D.C. Transit Sys., Inc.* (Order No. 984), *supra* note 22, just eight months before. Indeed, the discussion in Order No. 1057 is, by the Commission's own statement, taken virtually *in haec verba* from Order No. 984. The amicus curiae suggests that this heavy reliance on a prior order, and the record which underlay it, was improper. Our resolution of the efficiency issue renders unnecessary any expression of opinion on that point.

[131] Compare *Payne* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 7, 134 U.S.App.D.C. at 338-42, 415 F.2d at 918-22.

[132] The Commission did not indicate in either Order No. 1057 or Order No. 984 how it would judge efficiency, or what weight it would give it in deciding on the proper fares. Compare *D.C. Transit Sys., Inc.* (Order No. 1216) (WMATC May 19, 1972) (not yet reported), at 9-12.

[133] See *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 408. See also H.R. Rep. No. 1621, 86th Cong. 2d Sess. (1960): "Section 6(a)(3) specifies certain

efficiency into account at all when it set fares in Order No. 1052.[134] The reason given for this failure was that neither the staff nor the protestants brought forward evidence of mismanagement at the hearings. This reason is insufficient. The Commission cannot be said to have given "due consideration" to the efficiency factors where, as here, it declares that it would not consider it, and in any event there is so little evidence in the record that the Commission could not make any relevant findings.

The role of efficient management in Commission decisions in fare-increase applications was delineated in *D.C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission,*[135] the most recent pronouncement of this court on that subject. There we were called upon by Transit to review the Commission's denial in Order No. 1216[136] of

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functions which the Commission shall take into account in administering its ratemaking powers."

The requirement that an agency promulgating public utility rates take into account the efficiency of the utility's management is a common one. See, *e.g., Mountain States Tel. & Tel. Co.*, 82 P.U.R. (n.s.) 46, 49 (Ariz. Corp. Comm'n 1949); *United Fuel Gas Co.*, 46 P.U.R.3d 118, 123 (W.Va. Pub. Serv. Comm'n 1962). The question of efficiency of management is often closely connected with the question of adequacy of service. See *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 401-03, and cases there cited; *Western Light & Tel. Co.*, 17 P.U.R.3d 422, 428-30 (Okla. Corp. Comm'n 1957); E. Nichols & F. Welch, Rate of Return, chs. 20, 21 (1955 and Supp. A 1964).

[134] The section of the Commission's opinion entitled "The Return to be Allowed," in Order No. 1052, *supra* note 1, 85 P.U.R.3d at 14-18, does not mention efficiency of management at all.

[135] *Supra* note 4.

[136] *D.C. Transit Sys., Inc.* (Order No. 1216), *supra* note 132.

Transit's request for a fare raise. Underlying Order No. 1216 was an extensive study of Transit's operations and financial condition carried out by a consultant employed by the Commission for that purpose.[137] On the basis of the consultant's report, the Commission concluded that Transit's seriously unstable and risky financial situation bred such an uneconomical and inefficient transportation operation[138] that merely to increase fares would not cure either of those conditions.[139] The Commission, on that basis, denied Transit's proposed increase, and held that a prerequisite to any future elevation in fares was Transit's compliance with a group of Commission directives aimed at putting the company's financial house in order.[140]

On review of Order No. 1216, we upheld the Commission's findings and conclusions, and affirmed its refusal to revise the fares.[141] We found the Commission's view, as articulated in Order No. 1216—that it was required by the Compact to consider and weigh the interests of the public, including the public's right to economical, efficient and adequate transportation service[142]—to be "eminently correct,"[143] and we went on to state that

> The parties to the Compact could hardly have more plainly mandated the well settled principle that rate-

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[137] See *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 398.

[138] See *id.* at 401.

[139] See *id.* at 403.

[140] See *id.* at 403-04.

[141] *Id.* at 423.

[142] See text *supra* at note 129.

[143] *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 408.

> making appropriately encompasses an examination and evaluation of the economy and efficiency of a public utility's operations and the adequacy of its service.[144]

Accordingly, we affirmed the power of the Commission to precondition a fare raise upon terms calculated to safeguard the public interest in the caliber of the transportation provided.[145]

In the instant cases, the failure of the staff and the protestants to produce evidence of mismanagement certainly does not support an assumption that Transit was efficiently managed, and that was too vital a matter to be simply assumed away.[146] The Compact placed an obligation upon the Commission to develop the record on important matters when it was unsatisfied with the record produced by the parties. The Commission, like other agencies charged with the protection of the public interest, was not created simply to "provide a forum for the" proceeding.[147] The Commission was not at liberty to sit back and place "the responsibility for initiating or carrying through essential inquiries" on "private parties;"[148] instead, it had "an affirmative duty to assist the development of a meaningful record."[149] "[T]he Commisison's primary *raison d'etre* is

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[144] *Id.* (footnotes omitted.).

[145] *Id.* at 412-13.

[146] *Cf. Washington Gas Light Co.* v. *Baker, supra* note 108, 88 U.S.App.D.C. at 120-21, 118 F.2d at 16-17.

[147] *Office of Communications of United Church of Christ* v. *FCC*, 138 U.S.App.D.C. 112, 116, 425 F.2d 543, 547 (1969).

[148] *Payne* v. *Washington Metropolitan Area Transit Comm'n, supra* note 7, 134 U.S.App.D.C. at 342 n.106, 415 F.2d at 922 n.106.

[149] *Office of Communications of United Church of Christ* v. *FCC, supra* note 147, 138 U.S.App.D.C. at 117, 425 F.2d at 548.

furtherance of the public interest," we have said;[150] and it could not fulfill that function if it did not assure, by its own efforts, that its decision would be based on a full record.

We do not mean to suggest that the Commission could not rely on its staff. It certainly was not required that the Commission employ the services of a consulting firm every time it made an examination of Transit's efficiency. But the Commission could not base a decision on the silence of either the staff or the protestants, especially where there was no indication that anyone's attention was directed to the question at hand. The fact of the matter is that the staff in this very proceeding brought to the Commission's attention certain matters bearing upon Transit's efficiency. For instance, on the staff's suggestion, the Commission disallowed some executive salary increases,[151] and reinstated its previous command that Transit purchase new buses.[152] And the staff also pointed to a number of serious service problems, which the Commission commented upon.[153] But this was not the same thing as an inquiry directed to the staff concerning the efficiency of Transit's management. Such an inquiry presumably would have brought a response which, for example, could have pointed to innovations which Transit had or had not made to reduce expenses or to increase revenues. Once this sort of evidence was in the record, the Commission could rationally have taken Transit's efficiency into account in setting fares. In short, while the Commission, of course, could have depended

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[150] *Yohalem* v. *Washington Metropolitan Area Transit Comm'n*, 141 U.S.App.D.C. 17, 22, 436 F.2d 171, 176 (1970).

[151] See *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 13.

[152] *Id.* at 12.

[153] *Id.* at 28-29.

on its staff for this task, it still should have put the evidence on which it relied into the record and provided a sufficient articulation of its views for us to discern "the path which it followed" [154] to its conclusion about a just and reasonable return.

We will add, though it hardly seems necessary, that Transit bore a large share of the unfulfilled responsibility for producing a record on which findings as to its efficiency could have been made. Indeed, this should have been clear to Transit since its very first fare case, where the Public Utilities Commission, predecessor to the respondent Commission, said:

> It is the opinion of the commission that when the earnings position of a public utility necessitates an increase in rates, that such position requires proof of economical management as well as provident control of expenditures.[155]

Of all the parties, Transit, of course, was in the best position to present facts which might have demonstrated the efficiency of its management, yet it hardly met that sort of standard.[156]

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[154] *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 595 (1945).

[155] *D.C. Transit Sys., Inc.* (Order No. 4480), 25 P.U.R.3d 371, 378 (D.C. Pub. Utils. Comm'n 1958).

[156] Transit pointed to the testimony of its vice presidents as evidence of its efficient management. The most significant statement was that by its senior vice president who, when asked by Transit's counsel to comment on the company's operations, replied:

> D.C. Transit's efficiency has been favorably recognized throughout the transportation industry for many years. . . .
>
> D.C. Transit has consistently been granted the nationally known Maintenance Efficiency Award each year without exception since 1958 and we have been advised

The Commission's failure to assure that an adequate record was prepared, and to give explicit consideration in setting rates to Transit's efficiency, is particularly disturbing because that was a matter which went to the heart of the Commisison's duty. Like all public utility regulators, the Commission was designed to provide a substitute for competition for a monopoly affected with the public interest.[157] If the Commission had performed its task well, the company would have made a reasonable profit, not a monopoly profit, and resource allocation would not have been distorted.[158] But the Commission was not a substitute for competition unless it inquired into efficiency, for in a competitive market only an efficient company could make a reasonable profit.[159] If the Commission refused to perform

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that this honor will again be accorded to the Company for the year 1969. . . .

Appendix of Respondent-Intervenor at 25.

The Commission nonetheless found that "[t]here is no question that the company's maintenance program has been deficient. . . ." *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 11.

Transit also brought to light some other evidence which, it says, bears on efficiency—for example, its proposed use of computers for routing and its method of utilizing drivers whose contracts guarantee an eight-hour day. But by any reasonable measure Transit's showing was substandard, and in any event it was for the Commission, not this court, to evaluate the evidence and to take Transit's efficiency into consideration in setting fares.

[157] See J. Bonbright, Principles of Public Utility Rates 25 (1960), which points out that the very objective of regulation is "to serve as a substitute for competition." See also *Northern Natural Gas Co.* v. *FPC*, 130 U.S.App.D.C. 220, 226, 399 F.2d 953, 959 (1968).

[158] See *Northern Natural Gas Co.* v. *FPC*, *supra* note 157, 130 U.S.App.D.C. at 226, 399 F.2d at 959.

[159] *E.g.*, *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 4-5 (1958).

its statutory duty to make such an inquiry, then Transit had no incentive to discover and utilize cost-saving devices.[160] The alternative to an inquiry into efficiency, then, was to turn Transit into a high-cost plus profit company, and that plainly was not in the public interest.

We note, in this connection, that some serious questions about Transit's efficiency were raised. For example, petitioners point out, and we had previously noted,[161] that one of Transit's chronic problems was cash flow, a matter which the Commission had regularly considered in raising rates.[162] But there was no inquiry here, so far as we are aware, into methods, other than a fare increase, which Transit might have employed to eliminate this problem. Thus while the Commission assumed for ratemaking purposes that Transit had been paid the value of services it performed for a related corporation,[163] it never addressed the question

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[160] This is particularly true for Transit, since under its franchise, Pub.L. No. 757, 70 Stat. 598 (1956), and under Section 6(a)(4) of the Compact, *supra* note 4, the "primary test of the reasonableness of Transit's fares" is the "operating ratio method." *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 108, 121 U.S. App.D.C. at 400, 350 F.2d at 778. Thus if Transit's costs of service rose avoidably, any given operating ratio resulted in higher-than-necessary fares—provided, of course, it was not caught by the Commission and that the Commission did not deem the fares too high.

[161] *Yohalem* v. *Washington Metropolitan Area Transit Comm'n, supra* note 150, 141 U.S.App.D.C. at 27, 436 F.2d at 181.

[162] See, *e.g., D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 16.

[163] See *D.C. Transit Sys., Inc.* (Order No. 773), 72 P.U.R.3d 113, 124 (1968), *rev'd, Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59. The amount in question—some $23,400 a year—is a "conservative" estimate of the value to the *D.C. Examiner*, a news-

whether an efficient management with a cash flow problem would have let the debt remain uncollected. As another example, it is alleged that Transit had the highest operating costs per mile among a group of major urban transportation companies.[164] If this is true, it raised obvious questions about efficiency. To take a third example, the Commission stated that Transit's "maintenance program has been deficient and that, as a result, the number of buses available for service has been inadequate." [165] But this inadequacy did not spark an inquiry into management's efficiency, nor did it have any apparent effect on the rate of return allowed.[166] Finally, and without trying to be exhaustive, we note that while the Commission thought it "crystal clear . . . that the financial problem of the company is due to a declining ridership and increasing labor costs," [167] it made no investigation into what the company was doing to increase ridership,[168] or to reduce labor costs.

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paper owned by the principals of Transit, of the space on its buses that Transit made available for the distribution of the paper. *Id.*

[164] Brief for petitioner Democratic Central Committee at 15, relying on Exhibits 5-7 in *Payne* v. *Washington Metropolitan Area Transit Comm'n, supra* note 7.

[165] *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 11.

[166] See note 130, *supra.*

[167] *D.C. Transit Sys., Inc.* (Order No. 1057), *supra* note 47, 85 P.U.R.3d at 37.

[168] Indeed, the Commission took it upon itself to remedy "the inadequacy of the company's marketing program" by ordering "a soundly conceived and well-carried out program of imparting information to riders and potential riders about the specifics of the company's service. . . ." *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 23-24. Significantly, the Commission commented that it "believe[d] that [Transit's] efforts to maintain its existing ridership and to obtain new ridership have been impaired by its failure to

In sum, the Commission, in allowing the increase here, fell far short of what it later claimed in Order No. 1216 to be the required degree of concern with Transit's efficiency of management.[169] While we commended the improvement in the Commission's study of Transit's efficiency in Order No. 1216,[170] that cannot save the inadequate showing in Order No. 1052, which, together with other defects,[171] vitiates the fares set by that order.

IV. VIABILITY OF TRANSIT'S BUSINESS

We must now consider the final argument challenging the validity of Order No. 1052—the argument that the Commission, in granting Transit the increases permitted by that order, acted on the erroneous premise that a public utility is entitled to a return on its investment although its fiscal status may be so precarious that it would be unlikely to obtain any return if it were forced to compete on the open market.

Braided into Order No. 1052 is the cardinal assumption that the case law,[172] the Compact,[173] the Franchise Act,[174]

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promote adequately the use of its service." *Id.* at 23.

[169] *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4.

[170] *Id.* at ——, 466 F.2d at 415-16.

[171] See Part II, *supra*, and Part IV, *infra*. See also text *supra* at note 131.

[172] The Commission concluded that to compel Transit to operate without income sufficient to cover operating expenses and debt service as well as a return sufficient to attract investment capital "is to confiscate its property without due process of law." *D.C. Transit Sys., Inc.* (Order No. 1057), *supra* note 47, 85 P.U.R.3d at 36, citing *Bluefield Water Works & Improvement Co.* v. *West Virginia Pub. Serv. Comm'n*, 262 U.S. 679, 690 (1923).

[173] *Supra* note 4.

[174] Pub.L. No. 84-757, 70 Stat. 598 (1956).

and particularly the Constitution,[175] required the Commission to set the fares at a level which would insure Transit an adequate return after costs and expenses. Amicus curiae and the District of Columbia challenge this postulate. Since both the Compact and the Franchise Act demand, in addition to efficient and economical service, that Transit's rates remain reasonable,[176] and since a rash of recent fare increases has failed to solve Transit's financial plight,[177] it was error, they claim, for the Commission to grant another increase without a separate, prior determination as to whether at any fare level Transit was capable of consistently earning a profit and attracting investment capital.

Amicus curiae has shouldered the burden of this facet of the cases and the argument he constructs can be sketched roughly as follows. From January, 1968, to June, 1970, Transit was allowed four fare increases, raising the basic District of Columbia cash fare from 25 cents to 40 cents [178] —an overall increase of 60 percent. If increases in such rapid succession and in such proportions were necessary to keep the company in business, it follows that a serious question existed as to whether the business was or could be

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[175] See note 172, *supra*.

[176] Compact, *supra* note 4, tit. II, art. XII, §§ 3, 6(a).

[177] See text *infra* at note 178.

[178] *D.C. Transit Sys., Inc.* (Order No. 773), *supra* note 163, *aff'd in part, Powell* v. *Washington Metropolitan Area Transit Comm'n, supra* note 68, *rev'd, Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59; *D.C. Transit Sys., Inc.* (Order No. 880), *supra* note 30, *supplemented, D.C. Transit Sys., Inc.* (Order No. 882) (WMATC Oct. 29, 1968), *aff'd, Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 7; *D.C. Transit Sys., Inc.* (Order No. 984), *supra* note 22, *rev'd, D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, No. 23,958 (D.C. Cir. June 28, 1973); *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1.

made viable. It was improper, the argument continues, for the Commission to decline to investigate the cause of Transit's near-deficit operation, for such an investigation might have revealed that Transit was unable to maintain itself financially without an endless chain of fare elevations. In that event, the argument concludes, neither the Constitution, the Compact, the Franchise Act nor the case law would require or justify the increase in question; on the contrary, an unreasonable burden would fall on farepayers if fares were set at an artificially high level only to theoretically provide a return to the company. For precedent to support this position, amicus draws heavily on the Supreme Court's decision in *Market Street Railway Company* v. *Railroad Commission*.[179]

It is clear from the terms of the Compact [180] and the Franchise Act [181] that there are at least some circumstances in which Transit would not necessarily be entitled to an adequate return after costs and expenses. Section 6(a)(1) of the Compact requires the Commission, in deciding whether to suspend a fare change, to give consideration, among other things, to "whether the carrier is being operated economically and efficiently." [182] Section 6(a)(3) pro-

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[179] *Supra* note 3.

[180] *Supra* note 4.

[181] Pub.L. No. 84-757, 70 Stat. 598 (1956).

[182] The Compact, *supra* note 4, provides in relevant part at tit. II, art. XII, § 6(a)(1), that:

> The Commission, upon complaint or upon its own initiative, may suspend any fare, regulation, or practice shown in a tariff filed with it under Section 5 . . ., at any time before such fare, regulation, or practice would otherwise take effect. . . . In determining whether any proposed change shall be suspended, the Commission shall give consideration to, among other things, the financial condition of the carrier, its revenue require-

vides that, in prescribing just and reasonable fares, the agency shall take into account, *inter alia*, "the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service," as well as "the need of revenue sufficient to enable [the] carrier[] under honest, economical, and efficient management, to provide such service." [183] Similarly, Section 4 of the Franchise Act, promises that "if [Transit] does provide the Washington Metropolitan Area with a good public transportation system, with reasonable rates, Congress will maintain a continuing interest in the welfare of the Corporation [Transit] and its investors." [184] It follows from these portions of the Compact

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ments, and whether the carrier is being operated economically and efficiently. . . .

[183] Section 6(a)(3) is quoted in text *supra* at note 129.

[184] Franchise Act, Pub.L. No. 84-757, 70 Stat. 598-99 (1956), tit. I, pt. I, § 4, provides:

> It is hereby declared as matter of legislative policy that in order to assure the Washington Metropolitan Area of an adequate transportation system operating as a private enterprise, the Corporation [Transit], in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the Corporation an attractive investment to private investors. As an incident thereto the Congress finds that the opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on either the system rate base or on gross operating revenues would not be unreasonable, and that the Commission should encourage and facilitate the shifting to such gross operating revenue base as promptly as possible and as conditions warrant; and if conditions warrant not later than August 15, 1958. It is further declared as a matter of legislative policy that if the Corporation does provide the Washington Metropolitan Area with a good public transportation system, with reasonable rates, the Congress will

and the Franchise Act that, if Transit were not run economically, efficiently, and honestly, then it would not be entitled to the level of return contemplated by the Compact and Franchise Act.[185] This much is contested neither by the Commission nor by Transit.

The Franchise Act couples the continued interest of Congress in the company to the provision of "a good transportation system," [186] as well as the operation of such a system at "reasonable rates." [187] It would appear that to Congress it was important not only that the transit system be good —honest, efficient, and economical—but also that the rates be reasonable in themselves.[188] The Franchise Act also

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maintain a continuing interest in the welfare of the Corporation and its investors.

[185] *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 407-13, 418-23. See also Part III, *supra*. This principle had been recognized by District of Columbia regulatory agencies on at least two occasions prior to promulgation of Order No. 1052. In *D.C. Transit Sys., Inc.* (Order No. 984), *supra* note 22, the Commission warned that a return to investors would be withheld if service deficiencies were not improved:

> We also would put Transit on notice that in any future rate case if the level of service is allowed to drop below that required by the compact, the commission will consider denying any return to the equity holder so long as that condition exists.

81 P.U.R.3d at 455. And on an earlier occasion, the District of Columbia Public Utilities Commission pointed to improvident expenditures and indicated that it was setting rates as if Transit were operating efficiently. *D.C. Transit Sys., Inc.* (Order No. 4480), *supra* note 155, 25 P.U.R.3d at 378.

[186] Pub.L. No. 84-757, 70 Stat. 598-99 (1956), tit. I, pt. I, § 4, quoted *supra* note 184.

[187] *Id.*

[188] Like other regulatory bodies, the Commission was required to balance the interests of both the consumer and the

states that Transit "should be afforded the opportunity of earning such return as to make the Corporation an attractive investment to private investors." [189] This suggests, not a guarantee of a good return, but an opening to Transit to make such a return if it could. Section 6(a)(4) of the Compact contains a similar statement, and the same implication as to the "opportunity of earning such return as to make the carriers attractive investments to private investors." [190]

These clauses of the Franchise Act and the Compact seem to us to embody principles not essentially dissimilar from those which found Supreme Court approval in *Market Street Railway Company* v. *Railroad Commission*.[191] In *Market Street*, the Court upheld as non-confiscatory a fare which would not return a profit to the utility but would permit a return on the worth of the company's property

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investor. The scheme presented in the Franchise Act and the Compact recognized this balance. If Transit was efficient, it was to be permitted a fair return. If it was not efficient—that is, if it did not provide good service at a reasonably low cost—then it might be denied a return, or one which otherwise would have been higher. *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at ——, 446 F.2d at 407-10; *Washington Gas Light Co.* v. *Baker, supra* note 108, 88 U.S.App.D.C. at 119, 188 F.2d at 15; *Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *FPC*), 390 U.S. 747, 769-70, 790-98 (1968); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603, 610, 612 (1945); *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 606-08 (1942) (concurring opinion).

[189] Pub.L. No. 84-757, 70 Stat. 598 § 4 (1956), quoted *supra* note 184.

[190] Compact, *supra* note 4, tit. II, art. XII, § 6(a)(4), quoted *supra* note 49.

[191] *Supra* note 3.

valued at the price at which Market Street had agreed to sell the company to the City of San Francisco. The company's history was that of a failing enterprise to which a prior fare increase had brought, not additional revenues, but instead a steady decline in traffic; and the Court's opinion clearly distinguished between utilities which were financially healthy and those that were sick. It pointed out that

> . . . most of our cases deal with utilities which had earning opportunities, and public regulation curtailed earnings otherwise possible. But if there were no public regulation at all, this appellant [Market Street] would be a particularly ailing unit of a generally sick industry. The problem of reconciling the patrons' needs and the investors' rights in an enterprise that has pasesd its zenith of opportunity and usefulness, whose investment already is impaired by economic forces, and whose earning possibilities are already invaded by competition from other forms of transportation, is quite a different problem.[192]

And, the Court reiterated, "[i]t is idle to discuss holdings of cases or to distinguish quotations of this or other courts which have dealt with utilities whose economic situation would yield a permanent profit, denied or limited only by public regulation." [193] The considerations advanced in *Federal Power Commission* v. *Hope Natural Gas Company*,[194] the Court observed,

> . . . concerned a company which had advantage of an economic position which promised to yield what was held to be an excessive return on its investment and on its securities. They obviously are inapplicable to a company whose financial integrity already is hopelessly undermined, which could not attract capital on any possible rate, and where investors recognize as lost a part of what they have put in. It was noted in the

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[192] 324 U.S. at 554.

[193] *Id.* at 566.

[194] *Supra* note 188.

> *Hope Natural Gas* case that regulation does not assure that the regulated business make a profit. All that was held was that a company could not complain if the return which was allowed made it possible for the company to operate successfully. There was no suggestion that less might not be allowed when the amount allowed was all that the company could earn.[195]

Finally, the Court noted that the Constitution does not require a regulatory agency to fix rates "on an investment after it has vanished . . . or to maintain the credit of a concern whose securities already are impaired. The due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces." [196]

Market Street's theme, in short, is that there is no requirement that regulation be used to bolster and make profitable a company which would not otherwise be successful. That is the principle which the Commission should have followed, but did not. We do not say that, in actual fact, the circumstances of Market Street Railway were those of Transit. What we do say is that there certainly were sufficient indications that Transit might have been ailing to have alerted the Commission to have investigated (a) if and to what extent the company would have been able to make a profit if there were no regulation at all, and (b) if and to what extent Transit could then earn a sufficient return so as to make it an attractive investment at any level of fares which could have been deemed "reasonable."

We do not think it can be said, under the Compact and the Franchise Act, that any fare was "reasonable" no matter how high it was or how few riders were able to

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[195] 324 U.S. at 566 (citations omitted).

[196] *Id.* at 567.

pay the fare, so long as Transit was able to show a technical excess of gross income over expenses.[197] As we pointed out above, the Franchise Act stipulates "a good transportation system" as well as "reasonable rates";[198] the fact that the system was "good" did not automatically endow with reasonableness any fares necessary to sustain that good system at a profit. Reasonableness entails a consideration of the value of the service to the riders, the numbers who can use the service at the fares set, and the burden of those fares upon the riding public or important segments of it. Similarly, in appraising whether an operation is economical,[199] account must also be taken of the relationship between the level of the fares and the worth of services rendered to the riders. Service is not economical simply because it is honest, mechanically efficient, and as thrifty as it can be under the circumstances; it is not economical if the charge for the service must be set at inordinately high levels in order for the transit company to obtain a profit.[200]

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[197] We do not mean to imply that to be reasonable a fare must necessarily be within everyone's budget. See *Powell* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 68, at 5-8.

[198] See text *supra* at notes 186-87.

[199] See Compact, *supra* note 4, tit. II, art. XII, §§ 6(a)(1), 6(a)(3), quoted *supra* note 182 and text *supra* at note 129, respectively.

[200] *Key Sys. Transit Lines*, 17 P.U.R.3d 505 (Cal. Pub. Utils. Comm'n 1957) is but another variation of this approach. There the transit company refused to adopt and effectuate an improved transportation system designed to save operating expenses and to yield a 9.11% rate of return. In refusing to implement the new system, the company was "unlawfully denying to itself a reasonable opportunity to earn a fair return upon its property reasonably devoted to public use," *Id.* at 509, and the Commission felt no constitutional compulsion to relieve the company from its 2.7% return.

The record in these cases shows that ridership has declined considerably as the fares have risen.[201] In Order No. 1052, the Commission estimated that the decline would continue with the new fare raise to 40 cents.[202] Since 1966, the trends toward higher fares and lower ridership have been both steady and rapid.[203] The fall in ridership has borne, of course, most heavily on the poor and those who neither have the use of automobiles nor can well afford taxis.

The Commission has made a most conscientious effort to set Transit's fares at the proper level, and its task has been a most difficult and complex one. But we cannot avoid concluding that, performing its burdensome function, the agency has throughout acted on the erroneous postulate that it was compelled—no matter to what level it must raise the fares, how substantial the fall in ridership, and how financially sick Transit might be—to set the fares so that Transit could always earn a profit. To be sure, Transit was entitled to a reasonable opportunity to earn a fair

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[201] That was quite expectable, owing to the phenomenon in ratemaking known as the "resistance factor." See *Powell* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 68, at 6 n.17 and accompanying text. This factor was discussed by the Commission in the proceeding under review. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 7-8.

[202] *Id.* at 8.

[203] From 1960 through 1967, when Transit's basic District of Columbia cash fare remained at a constant 25 cents, the total number of revenue passengers changed from 134,925,-430 in 1960 to 133,646,024 in 1967, with a high point of 137,771,403 in 1966 and a low point of 131,685,316 in 1963. S.Rep. No. 91-760, 91st Cong., 2d Sess. 24-25. In 1970, on the basis of a 40-cent fare, the Commission projected the ridership at between 112,785,616 and 113,253,766. *D.C. Transit Sys., Inc.* (Order No. 1052), *supra* note 1, 85 P.U.R.3d at 8.

return from its operations.[204] It was not, however, for the Commission to insure a return. Neither the Compact[205] nor the Franchise Act[206] authorized a guarantee, nor did due process require it[207] nor, as the cases make plain, was it the Commission's prerogative to afford it.[208] Though the Commission has also commented that it has considered the public interest in restraining the rise in fares, we are convinced that the incorrect postulate to which we have referred has initially infected the Commission's whole thinking and its ratemaking process. Order No. 1052, in particular, cannot be judged apart from that mistaken premise, which we judge to be at its core. For this reason, as well as for the others we discuss in this opinion,[209] that order cannot stand.

V. DISPOSITION

For three reasons we have concluded that Order No. 1052 is invalid. First, the Commission should have credited to Transit's farepayers, to the extent not exhausted by its

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[204] *E.g., Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Serv. Comm'n*, 262 U.S. 276, 290-91 (1923) (separate opinion). The return of which we speak would embrace, of course, reimbursement of all reasonable costs of providing the service and reasonable compensation for the public's use of the capital utilized in the enterprise.

[205] See text *supra* at notes 182-90.

[206] See text *supra* at notes 182-90.

[207] *Market Street Ry.* v. *Railway Comm'n, supra* note 3, 324 U.S. at 566-67; *FPC* v. *Hope Natural Gas Co., supra* note 188, 320 U.S. at 603; *FPC* v. *Natural Gas Pipeline Co., supra* note 188, 315 U.S. at 590; *Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Serv. Comm'n, supra* note 204, 262 U.S. at 291. See also *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App. D.C. at ——, 466 F.2d at 418-23.

[208] See cases cited *supra* note 207.

[209] See Parts II, III, *supra*.

prior similar obligation,[210] the amount by which the company's lands increased in value up to the time they were removed from operating status.[211] Second, in determining Transit's right to higher fares, the Commission should have inquired into the efficiency of Transit's management—a necessary prerequisite, under the terms of the Compact, to considering any fare raise.[212] And finally, the Commission's decision should have been guided by the precept that Transit was entitled to an opportunity to earn a return on its investment but not to a guaranteed return, nor necessarily to a fare increase where an examination of its economic health could have revealed that it was incapable of maintaining profitable operations under any reasonable rate of return allowed.[213]

Given these infirmities in Order No. 1052, we are faced with the question of the disposition mandated. Defective fare orders cannot be cured by retroactive ratemaking,[214] nor is the Commission in a position to promulgate any new fares for Transit in light of the recent public takeover of its transportation assets and operations.[215] Nevertheless, we cannot give legal effect to the invalid fares set in Order No. 1052 by allowing that order to stand.[216] As in *Demo-*

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[210] See *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 85-86, and text *supra* following note 84.

[211] See Part II, *supra.*

[212] See Part III, *supra.*

[213] See Part IV, *supra.*

[214] See cases cited *supra* note 126.

[215] See note 117, *supra.*

[216] *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 78-79; *Williams* v. *Washington Metropolitan Area Transit Comm'n, supra* note 75, 134 U.S.App.D.C. at 363, 415 F.2d at 943.

cratic Central Committee,[217] decided today, and as in its decisional forerunner, *Williams* v. *Washington Metropolitan Area Transit Commission*,[218] we find the appropriate avenue of relief here to be restitution.[219]

The Commission is in an excellent position, both by virtue of its administrative expertise and its familiarity with Transit's situation to conduct the investigations essential to ascertainment of restitution to be awarded here. For that purpose, we remand the case to the Commission.[220] Necessarily, three matters, correlative to the three defects we have found in Order No. 1052, must be explored by the Commission. The first is the amount of the increase in market value over book value of lands which Transit moved below the line prior to the issuance of Order No. 1052,[221] and the amount of the increase remaining after the application to be made in *Democratic Central Committee*.[222]

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[217] *Supra* note 59, at 78-82.

[218] *Supra* note 75, 134 U.S.App.D.C. at 362-64, 415 F.2d at 942-44.

[219] Order No. 1052, unlike the fare orders in *Democratic Central Committee* and *Williams*, has not been superseded by later orders. But the granting of relief is, nevertheless, complicated by the recent public takeover of Transit's operations, see note 117, *supra*, and the consequent termination of the Commission's faresetting duties. See Compact, *supra* note 4, tit. III, art. XI, § 41, art. XIII, § 60; *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at 85-86. Thus, as in *Democratic Central Committee* and *Williams*, restitution is the appropriate method of restoring to the riders any unlawful excess from fares collected under Order No. 1052.

[220] Compare *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 59, at 83-85.

[221] See Part II, *supra*.

[222] *Supra* note 59, at 85. See text *supra* following note 84.

This is perhaps the least difficult of the three asisgnments since it involves essentially the same calculations required of the Commission by our opinions today in *Democratic Central Committee* [223] and *Bebchick*.[224]

Once ascertained, the net amount of this value-appreciation must be credited to the farepayers. The specific means by which the riders are to be benefited thereby must also be worked out by the Commission, preferably in consultation with the Washington Metropolitan Area Transit Authority, the new owner of Transit's system.[225]

The other two matters which the Commission must look into relate to remedying the other two defects in Order No. 1052. One is the determination of the impact, if any, which the efficiency of Transit's management should have had on its right to fare increases at the time of the order.[226] The other is the evaluation, which *Market Street Railway* [227] required, as to whether Transit's then financial position would have enabled it to consistently maintain a profitable mass transportation system under any rate of return.[228]

The Commission has the benefit now of the Loconto report [229] and the other evidence adduced in the hearings

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[223] *Supra* note 59, at 85.

[224] *Supra* note 78, at 36-37.

[225] See note 117, *supra*. This is the procedure we suggested in *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 59, at 86.

[226] See Part III, *supra*.

[227] *Supra* note 3.

[228] See Part IV, *supra*.

[229] See Part III, *supra*, at notes 136-39; *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, ——U.S.App.D.C. at ——, 466 F.2d at 398-401.

on Order No. 1216 [230]—evidence which convinced the Commission that Transit was operating inefficiently and under perilous economic circumstances two years after the fare-setting in Order No. 1052.[231] The Commission is free to draw upon these sources for such assistance as they may afford in the performance of these duties on remand.

It is conceivable that after reconstructing Transit's situation at the time of Order No. 1052, and after applying itself to the factors which we have found that it neglected, the Commission might nevertheless conclude that Transit's request for higher fares was properly granted. In that event, the only infirmity in Order No. 1052 having any practical effect would be the failure to benefit the riders by the increased market value of the lands moved below the line. That would be handled as we have suggested above and in *Democratic Central Committee.*[232]

Order No. 1052 is set aside. The case is remanded to the Commission for further proceedings consistent with this opinion. Our jurisdiction over the case is retained in full.

So ordered.

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[230] See *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n, supra* note 4, —— U.S.App.D.C. at ——, 466 F.2d at 401-03.

[231] *Id.*

[232] *Supra* note 59, at 85-88.

MacKinnon, *Circuit Judge,* concurring in part and dissenting in part: For the reasons set out in my opinion in today's companion case, *Democratic Central Committee* v. *WMATC,* No. 21865 (hereinafter No. 21865), I concur generally in this decision, dissenting only from Part II (and Part V insofar as it necessarily directs the Commission to remedy the alleged defects delineated in Part II).

I would just like to add that it seems odd that the majority in this case manages to find some sort of "implicit" legislative intent in the Franchise Act (granting Transit its charter) that mandates the result reached. This intent is apparently derived from Congress' total silence on the subject which the majority interprets as meaning that Congress could not have intended any result other than that reached in this case. It is argued, *supra* at 23-25, 30, that nothing in the Act suggested that gain should accrue to the investors. Yet since that would have been the result absent any provision to the contrary, Congress' silence on the matter would seem infinitely more supportive of an implicit acquiescence in awarding the gain to the investors rather than the converse as argued by the majority, *supra* at 30. This strikes me as a very weak strut to support the logic of the majority's decision and is really nothing more than a restatement of the view that the history and circumstances of Transit are such that it would be desirable to award any and all gains to the farepayers. Here the majority seeks to clothe its basic equitable arguments in the garb of congressional intent. As an indication of a desperate need to lend some legal substance to its vague equitable leanings, this tactic serves only to weaken the majority's position, rather than strengthen it.

Transit was taken over by the public authorities on January 14, 1973 and the operating officials are already considering demands for fare increases in order to meet op-

erating expenses. This is some indication that the past management was perhaps not as inefficient as has been contended and that the fare increases sought by Transit from time to time over the years were not as unreasonable as their opponents contended. In fact, local fares were generally not out of line with bus fares nationally. For the record there is appended in the margin fares in other comparable urban areas. (Exhibit 14, p. 1).

CASH FARES, TRANSFERS AND MAXIMUM FARES IN 46 LARGEST U.S. AND CANADIAN CITIES

(SOURCE: A.T.A. FARE SUMMARY BOOKLET)

City	*Cash Fare*	*Tickets or Tokens*	*Transfer*	*Maximum Fare Within City Incl. Transfer*	*Ownership*
Kansas City, Missouri	$.50	None	$.05	$.65	Public
Akron, Ohio	.40	5/$1.75	.02	.42	Private
Chicago, Illinois	.40	None	.05	.45	Public
St. Louis, Missouri	.40	None	.05	.45	Public
Atlanta, Georgia	.35	3/$.90	.05	.40	Private
Cincinnati, Ohio	.35	5/$1.50	.10	.55	Private
Cleveland, Ohio	.35	5/$1.75	.05	.40	Public
Denver, Colorado	.35	None	.05	.40	Private
Houston, Texas	.35	10/$3.00	Free	.55	Private
Louisville, Kentucky	.35	10/$3.50	.05	.40	Private
Montreal, Canada	.35	3/$.90	Free	.35	Public
Pittsburgh, Pennsylvania	.35	None	.05	.45	Public
Portland, Oregon	.35	None	Free	.35	Private
Toledo, Ohio	.35	5/$1.75	.05	.55	Private
Baltimore, Maryland	.30	.30	.05	.35	Private
Birmingham, Alabama	.30	20/$5.50	.05	.55	Private
Buffalo, New York	.30	10/$3.00	.05	.35	Private
Columbus, Ohio	.30	5/$1.50	Free	.30	Private
Dallas, Texas	.30	None	Free	.70	Public
Detroit, Michigan	.30	7/$2.00	.05	.35	Public
Fort Worth, Texas	.30	8/$2.00	.02	.37	Private
Indianapolis, Indiana	.30	None	.05	.35	Private
Los Angeles, California	.30	.30	.05	•	Public

CASH FARES, TRANSFERS AND MAXIMUM FARES IN 46 LARGEST U.S. AND CANADIAN CITIES (Continued)

City	*Cash Fare*	*Tickets or Tokens*	*Transfer*	*Maximum Fare Within City Incl. Transfer*	*Ownership*
Memphis, Tennessee	.30	None	.05	.35	Public
Milwaukee, Wisconsin	.30	10/$2.75	Free	.40	Private
New York, New York (C)	.30	.30	Free	.55	Public
Oklahoma City, Oklahoma	.30	None	Free	.40	Public
Omaha, Nebraska	.30	36/$9.00	.02	.32	Private
Phoenix, Arizona	.30	None	.05	.45	Private
Philadelphia, Pennsylvania	.30	None	.05#	.47	Public
San Diego, California	.30	4/$1.00	Free	.30	Public
Toronto, Canada	.30	4/$1.00	Free	.60	Public
Honolulu, Hawaii	.25	5/$1.00	Free	.35	Private
Long Beach, California	.25	5/$1.00	Free	.32	Public
Miami, Florida	.25	None	Free	.25	Public
Minneapolis-St. Paul, Minn.	.25	None	Free	.25	Private
Newark, New Jersey	.25	None	.10-.20	**	Private
New York, New York (A)	.25	None	Free	.55	Private
New York, New York (B)	.25	None	Free	.55	Private
Norfolk, Virginia	.25	10/$2.25	Free	.40	Private
Oakland, California	.25	4/$1.00	Free	.35	Public
Rochester, New York	.25	8/$2.00	.02	.27	Public
San Antonio, Texas	.25	None	.02	.40	Public
Seattle, Washington	.25	.25	Free	.45	Public
Boston, Massachusetts	.20	.20	None	.20@	Public

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1973

FILED SEPTEMBER 25, 1973

HUGH E. KLINE, *Clerk*

No. 21865

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, ET AL., *Petitioners*

v.

THE WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondent*

D. C. TRANSIT SYSTEM, INC., *Intervenor*

No. 23720

LEONARD N. BEBCHICK, ET AL., *Petitioners*

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondent*

D. C. TRANSIT SYSTEM, INC., *Intervenor*

No. 24398

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, ET AL., *Petitioners*

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondent*

D. C. TRANSIT SYSTEM, INC., *Intervenor*

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1973

No. 24428

BLACK UNITED FRONT, *Petitioner*

WASHINGTON AREA, ETC., *Intervenor*

v.

WASHINGTON METROPOLITAN AREA TRANSIT

D.C. TRANSIT SYSTEM, INC., *Intervenor*

BEFORE: ROBINSON and MACKINNON, *Circuit Judges* and *DAVIS, *Judge*, UNITED STATES COURT OF CLAIMS.

ORDER

On consideration of the motions by American Gas Association, Washington Gas Light Company, and Potomac Electric Power Company for leave to file statements as *amici curiae* in support of petition for rehearing and suggestion for rehearing *en banc*, and of the petitions for rehearing by D.C. Transit, Inc., and Black United Front, it is

ORDERED by the Court that the Clerk is directed to file the aforesaid statements by American Gas Association, Washington Gas Light Company, and Potomac Electric Power Company as *amici curiae*, and, it is

FURTHERED ORDERED by the Court that the aforesaid petitions for rhearing are denied.

Per Curiam
For the Court:
HUGH E. KLINE,
Clerk

By: DANIEL M. CATHEY
Daniel M. Cathey
Deputy Clerk

*Sitting by designation pursuant to Title 28 U.S.C. Section 293(a).

MOTION FILED SUPREME COURT, U. S.
DEC 26 1973

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-971

D. C. TRANSIT SYSTEM, INC.,
Petitioner,

v.

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, BLACK UNITED FRONT, WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents.

MOTION OF POTOMAC ELECTRIC POWER COMPANY FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JACK E. McGREGOR
EDWARD A. CAINE
1900 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Attorneys for Amicus Curiae

December 26, 1973

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No.

D. C. TRANSIT SYSTEM, INC.,
Petitioner,

v.

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA,
BLACK UNITED FRONT,
WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents.

MOTION OF POTOMAC ELECTRIC POWER COMPANY FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Comes now Potomac Electric Power Company (Pepco) and, pursuant to Rule 42 of this Court's Rules, moves this Court grant Pepco leave to file the accompanying brief *amicus curiae* in support of the Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit filed this day by D.C. Transit System, Inc. to review the opinions and judgments of the Court of Appeals rendered on June 28, 1973 in *Democratic Central Committee of the District*

of Columbia v. *Washington Metropolitan Area Transit Com'n*, No. 21, 865, *Democratic Central Committee of the District of Columbia* v. *Washington Metropolitan Area Transit Com'n*, No. 24,398, and *Black United Front* v. *Washington Metropolitan Area Transit Com'n*, No. 24,428. In support of its motion, Pepco submits that it has a direct and substantial interest in the outcome of this litigation. In support whereof, Pepco shows as follows:

In reversing orders of the Washington Metropolitan Area Transit Commission there under review, the Court of Appeals has held as a general proposition that a utility, notwithstanding the fact of ownership, which sells or otherwise disposes of its land out of Utility Property as no longer used and useful in the utility enterprise does not automatically receive the benefit of any appreciation in the value of land; but that depending upon the circumstances of the case the ratepayers may receive this benefit through lower rates. Pepco submits this proposition is erroneous and that if it were used as general precedent in regulatory practice, it would have a seriously deleterious effect upon the utility industries.

Pepco submits that it is significant that the doctrinal change from the constitutional requirement of fair return on fair value for utility ratemaking purposes was not argued to the Court save in Pepco's statement *amicus curiae* in support of rehearing or rehearing *en banc*, but that an analysis of that doctrinal change in economic regulation and public economic policy forms the single underpinning of the Court of Appeals' general proposition as stated above. Pepco submits that the granting of leave to file the accompanying brief *amicus curiae* will therefore result in more balanced argument to this Court on the constitutional issue here presented.

Pepco is regulated as to its rates for the retail sale of electric energy in the District of Columbia by the Public Service Commission of the District of Columbia, which, under the name of "Public Utilities Commission," is the predecessor of the Washington Metropolitan Area Transit Commission. Pepco's

rates so regulated must provide a reasonable opportunity to earn a fair return upon the fair value of Pepco's property used and useful in the utility enterprise. The Public Service Commission insofar as its regulation of Pepco has adopted the Federal Power Commission's Uniform System of Accounts Prescribed for Class A & B Public Utilities and Licensees. This system is in all material respects the same as the Uniform System of Accounts adopted by the Washington Metropolitan Area Transit Commission.

The Court of Appeals has raised a question of seriously adverse impact to Pepco, and to other utilities similarly situated, by overturning consistently applied administrative accounting practice which is the same as that employed by all other federal rate regulatory agencies of similar nature. Furthermore, retroactive application of the Court's novel precepts as to nondepreciable assets underscores the importance of these cases on the petition for the writ of certiorari.

Although the Court of Appeals no longer hears appeal from orders of the Public Service Commission or the Washington Metropolitan Area Transit Commission, it does receive petitions for review of final orders of the Federal Power Commission. It is therefore particularly significant that the Federal Power Commission has recently ruled on point that ratepayers have no interest in the property of public utilities pursuant to the Federal Power Act, 16 U.S.C. §791, *et seq.*[1] The *Duke Power Case,* which includes at least two other significant issues, is presently before this very same Court of Appeals on petitions for review.[2] Therefore, panels of the Court of Appeals may initially split on the issue before this Court on the petition for certiorari, or the issue will be decided against the Federal Power Commission and thereby directly affect

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[1] *Re Duke Power Company,* 48 FPC , , 97 PUR 3d 396, 405-406 (1972).

[2] *Electricities of North Carolina* v. *Federal Power Com'n,* D.C. Cir. Nos. 73-1185 and 73-1237, petitions for review filed February 16 and March 6, 1973, respectively. The proceeding has not yet been set down for oral argument.

every Public Utility and Natural Gas Company pursuant to the Federal Power Act, *supra*, and the Natural Gas Act, 15 U.S.C. §717, *et seq.*, in the country. In any event, the Federal Power Commission, relying upon its disposition of the issue in the *Duke Power Case*, has reaffirmed its position on the treatment of appreciation in the value of land assets by rulemaking.[3]

WHEREFORE, Pepco urges this Court grant Pepco leave to file the accompanying Brief *Amicus Curiae* in Support of Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit in order that this Court may receive, *inter alia*, argument as to the relevance of the doctrine by which the Court of Appeals underpins its general constitutional proposition, hereinbefore stated, as to increases in the value of land.

Respectfully submitted,

Edward A. Caine
Of Counsel

Jack E. McGregor
Edward A. Caine
1900 Pennsylvania Avenue, N.W.
Washington, D. C. 20006

Attorneys for Potomac Electric Power Company,
Amicus Curiae
Washington, D. C.
December 26, 1973

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[3]Order No. 473, Docket No. R-412, 49 FPC , 38 F.R. 4947 (February 15, 1973).

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No.

D. C. TRANSIT SYSTEM, INC.,
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v.

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, BLACK UNITED FRONT, WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents.

BRIEF *AMICUS CURIAE* OF POTOMAC ELECTRIC POWER COMPANY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

INTEREST OF *AMICUS CURIAE*

The interest of the *amicus curiae* is set forth in the motion which this brief accompanies. All references to the opinions below are cited to pages of Petitioner's appendices accompanying the petition for a writ of certiorari.

ARGUMENT

On June 28, 1973, the United States Court of Appeals for the District of Columbia handed down six decisions relating to nine dockets on petitions for review of several Opinions and Orders of the Washington Metropolitan Area Transit Commission (Commission), all final orders relating to rate cases of D.C. Transit, Inc. (Petitioner). The question dealt with here, relating to two of these decisions, is whether upon sale or other disposition of land out of Utility Property used and useful in the utility enterprise, the benefit of any appreciation in market value over original cost at the time of sale or other disposition must or may accrue to the investor or the ratepayer. This broad question was answered by the Court of Appeals in the following manner:

a. the fact of ownership of the property does not necessarily mean the investor is entitled to the appreciation; therefore, the determination must be according to where lie the "equities" of the case;

b. gain follows risk of loss, and benefit follows burden.

The proposition of the Court of Appeals relating to disposition of capital gains on land is of extraordinary importance. Although the Court in large measure intimately relates the parameters of the question to D.C. Transit's franchise and the resulting congressional requirement of the track-removal program, nowhere is it clear that this proposition went off on its relation to that program. Nor could it be entirely, for the Court of Appeals preliminarily answers the general question of who benefits from capital gains on land by finding generally that the owner does not necessarily so benefit. Accordingly, it may be argued that these opinions form precedent not only as to the latter general proposition but also as to disposition of the "equities", even when the facts of the case should strongly limit similar disposition.

Pepco submits that the Court of Appeals' reasoning as to the disposition of appreciation in the value of land assets is eminently incorrect and that the Court's discussion of the doctrine of fair value for ratemaking purposes, which is the Court's only support for the latter disposition, is entirely

inappropriate. Therefore, Pepco submits that to force an accounting of any such appreciation to the benefit of the ratepayer contravenes the Fifth Amendment of the Constitution and is otherwise insupportable in law or equity.

As to the petition for a writ of certiorari, Pepco submits that it is significant that the doctrinal change from the constitutional requirement of fair return on fair value as delineated in *Smyth* v. *Ames*, 169 U.S. 466 (1898), was not argued to the Court of Appeals whatsoever until Pepco filed its statement *amicus curiae* in support of the petition for rehearing and suggestion for rehearing en banc, but that an analysis of that doctrinal change in economic regulation and public economic policy forms the single underpinning of the Court's general determination. Neither Pepco nor other utility enterprises were accordingly aware of the imminent forthcoming of the Court of Appeals' disposition in the face of some 100 years of consistent treatment throughout the United States on all regulatory levels.[4] Accordingly, Pepco only sought (and was granted) its *amicus curiae* status before the Court of Appeals in the rehearing stage. Pepco now submits that this Court should grant the petition of D.C. Transit, Inc. for the issuance of the writ in order to review the Court of Appeals' holding relating to the constitutional issue of the disposition of capital gains on land belonging to a public utility when the land is transferred out of Utility Property and is no longer reasonably used and useful in the utility enterprise.[5]

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[4]See separate opinion of Judge MacKinnon, App. A, p. 100a.

The precedent against the Court is enumerable although not susceptible of specification, for throughout the United States the opposite result has been so naturally ingrained that the issue was apparently litigated only twice (App. A, pp. 17a-20a) and each went off on the system of accounts used in the particular jurisdiction. Administrative decisions in the District of Columbia have uniformly held the utility is entitled to the benefit (App. A, p. 23a).

[5]See page 3, *supra*, where in the accompanying motion Pepco discusses the significance of the Federal Power Commission's holding in *Re Duke Power Company* and the subsequent petitions for review lodged in the Court of Appeals.

I

CONFISCATING UTILITIES' PROPERTY IN THE FORM OF APPRECIATION IN THE VALUE OF THEIR LAND ASSETS BY REDUCING OTHERWISE JUST AND REASONABLE RATES CONSTITUTES TAKING WITHOUT DUE PROCESS AND WITHOUT COMPENSATION.

The Court of Appeals devotes many pages of opinion to a discussion of the doctrinal change in economic regulation resulting from the change in definition of the constitutional necessity for the reasonable opportunity of a public utility to earn a fair return on fair value. The Court concludes that therefore the benefit of appreciation in land values may accrue to the ratepayers rather than the investors. The Court further concludes that, "the doctrinal consideration upon which pronouncements to the contrary have primarily rested has lost all present day vitality" (App. A, p. 27a). Nevertheless, Pepco submits that the doctrine of fair value enunciated in *Smyth* v. *Ames*[6] and in effect withdrawn after many years by *Federal Power Com'n* v. *Hope Natural Gas Co.*[7] is entirely inapposite to the question before the Court of Appeals as well as the basic question before this Court.

Smyth v. *Ames* stood for the proposition that a utility was entitled to a reasonable opportunity to earn *from its ratepayers* a fair return upon the fair value of its property used and useful in the utility enterprise at the time of its use.[8] The only relevant change in that doctrine effected by *Hope Natural Gas* is

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[6] 169 U.S. 466 (1898).

[7] 320 U.S. 591 (1944).

[8] 169 U.S. at 546; *San Diego Land & Town Co.* v. *National City*, 174 U.S. 739, 757 (1899).

that original cost may form the base against which the fair return is calculated, for "fair value is the end product of the process of ratemaking not the starting point as the Circuit Court of Appeals held" (320 U.S. at 601).[9] As a constitutional proposition, fair value for ratemaking purposes may be held to be original cost.

Left entirely unaffected by *Hope Natural Gas*, as well as *Southwestern Bell*[10] and *Natural Gas Pipe*,[11] is the fact that the doctrine only mandates the obligation of the ratepayer to pay a reasonable sum for usage of the asset.

Therefore, the utility is entitled to a reasonable opportunity to recoup the cost of service *from the ratepayers* who occasion the cost. No more, but no less, is required of the ratepayer, the Court of Appeals' assertion to the contrary notwithstanding (App. A, p. 35a). It does not follow by any means that the ratepayer is then entitled to capital gains on property purchased by the utility for use in the utility enterprise. Capital gains simply do not form part of the cost of service and that is the reason ratepayers need not pay for the use of assets based upon their value. Accordingly, since the capital gains have only to do with the fact of ownership, the utility is entitled to the benefit thereof.

Pepco submits that the Court of Appeals erred in concluding, as it does (App. A, pp. 31a-32a), that if a utility possesses an indefeasible right to the appreciation in value of

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[9]Par. 7 of the Public Service Commission Law of the District of Columbia creates the District of Columbia a fair value jurisdiction as to regulation of electric, gas, and transportation enterprises, 43 D.C. Code §306. Fair value for ratemaking purposes in this jurisdiction is original cost.

[10]*Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Serv. Com'n*, 262 U.S. 276, 289 (1923), concurring opinion of Justices Brandeis and Holmes.

[11]*Federal Power Com'n* v. *Natural Gas Pipeline Co. of America*, 315 U.S. 575 (1942).

the utility's operating assets, then the rate base "could be set only at the true value of the assets." As previously set forth herein, the cases only show the *ratepayer* need only pay return on the capital originally invested in the asset. Nowhere did the cases purport to defeat the incidence of ownership of the land asset in the utility, and thus it does not follow that if the ratepayer need only pay for use of the asset, the utility can only recoup its toll for usage.[12]

Pepco submits that the Court of Appeals misapprehends the purport of *Board of Public Util. Com'ers* v. *New York Tel. Co.*, 271 U.S. 23, 31-32 (1926), where the Supreme Court stated on point that, "By paying bills for service [the ratepayers] do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company" (See App. A, pp. 20a-21a, 29a). Public utilities do not give up any interest in their property by utilizing their property in the utility enterprise and by being subjected to utility regulation. Pepco submits that no such inference is intended by the phrase "devoted to public service".

Strictly legislative regulation of public utilities was originally enacted in the public interest to counteract the lack of competition regarding certain industries which were proven not to be able to function effectively in a normally competitive atmosphere, due to their capital-intensive nature and the comparative inelasticity of demand for their commodity or service.[13] Regulatory commissions were thereafter instituted in turn, to take the place of competition, in order to replace resulting static legislative ratemaking and service-regulation by utilizing continuous oversight within the commission's expertise. The purpose of regulatory agencies is therefore to stand in large measure between the utilities and the public as more normal competition would otherwise have stood.

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[12]The Court of Appeals' holding herein in fact defeats even the utility's entitlement to payment for use, for the offset of the benefit to ratepayers against their obligation to pay for use of the land asset would reduce the amount of payment effectively in some cases to zero.

[13]*Munn* v. *Illinois*, 94 U.S. (Otto) 113 (1877).

In *Munn v. Illinois*, it was said that in order to be regulated an enterprise must be affected with the public interest and in effect devoted to public service. Neither of these propositions are susceptible of definition, but each has tended to cloud the atmosphere of economic regulation even to the extent of negating to some degree the purpose of regulation, which is merely to take the place of more normal competition. Pepco submits that, in *Nebbia v. New York*, 291 U.S. 502, 533 (1934), the Supreme Court laid to rest what was intended in *Munn v. Illinois*, by which Pepco submits that the Supreme Court in *Nebbia* affirmed the underlying proposition stated above as to the purpose of regulation:

> "The statement that one has dedicated his property to a public use is, therefore, merely another way of saying that if one embarks in a business which public interest demands shall be regulated, he must know regulation will ensue."

This Court further stated that the question to be determined is whether the regulatory law possesses "a reasonable relation to a proper legislative purpose" (291 U.S. at 536). If the question is answered affirmatively, the inquiry need go no further as to whether or not the enterprise is somehow affected with the public interest or devoted to public use.

A utility enterprise is comparable to non-regulated industry insofar as the fact that utilization of assets in a utility enterprise gives no more right to its customers to any capital gains associated with that property, than utilization of assets by any industrial concern gives a similar right to its customers. As this Court held in the *New York Telephone Case, supra*, utility status does not alter this fact.

Furthermore, as to the Court of Appeals' consideration of the departure from the concept of fair value for utility ratemaking purposes, fair value was never intended to constitute fair market value.[14] Fair value theoretically was comprised of

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[14] *McCardle* v. *Indianapolis Water Co.*, 272 U.S. 400, 410 (1926); *Los Angeles G. & E. Corp.* v. *Railroad Commission*, 289 U.S. 287, 305-306 (1933); *West* v. *Chesapeake & P. Tel. Co.*, 295 U.S. 662, 672 (1935).

several factors not limited to a consideration of original cost and reproduction cost new (market value in the case of land assets). Under fair value, market value in excess thereof was treated as surplus, for even then the utility was not entitled to its toll for usage *from the ratepayer* based upon market value; for example,

> "[I]f real estate has enhanced to such an extent that a return upon its value would be in excess of the reasonable value of the use for the purposes to which it is devoted, the excess value should be treated as surplus and not as a part of the investment upon which the public is required to compensate the owner for the service of the property." (*City of Appleton* v. *Appleton Water Works Co.*, 4 Wisc. RR Com'n 501, 579 (1910); immediate predecessor of the Wisconsin Public Service Commission).

Obviously then the fair value doctrine or the change therefrom is inapposite to the issue before this Court. Surely the general proposition that investors need not in all circumstances receive the benefit of such capital gains, which the Court of Appeals sought to draw from the receding of the doctrine of *Smyth* v. *Ames*, is a *non sequitur*. The result adjudged by the Court of Appeals therefore violates the Fifth Amendment in that private property has been taken without due process and without compensation.

II

DETERMINATION OF ANY ATTENDANT EQUITIES WOULD COMMAND THAT A UTILITY NOT BE SO DEPRIVED OF ITS PROPERTY, IN THE ABSENCE OF EXTRAORDINARY CIRCUMSTANCES.

Once the Court of Appeals found by an analysis of the fair value doctrine that investors no longer automatically receive the ownership benefit of the appreciation in the value of land assets, the Court next sought the "equities" of the case. The Court first found that gain should follow risk of loss; secondly the Court found that no one bears the risk of loss as to land; and lastly the Court found that the ratepayer should receive the

benefit, for benefit follows burden.[15] On the other hand there is no necessary relation between risk of gain and risk of loss nor between benefit and burden. Pepco submits that the Court of Appeals uncritically accepted these relationships, for a utility, in the same manner as any other industrial concern, does not utilize capital assets in the utility enterprise for any other reason than to meet the demands of its customers for its commodity or service. Moreover, the Court asserted *ipse dixit* that the ratepayer bears the land burden and thus should reap the gain, when in fact the financial and operating burden of the land itself rests entirely on the utility; all the ratepayer must do is pay for the use he makes of it.

The risk of loss as to land value at the time of disposition was borne by Petitioner and not its ratepayers.[16] If the Court of Appeals were correct in stating that the gain as to land should follow risk of loss, then the gain would inure to the benefit of Petitioner. Pepco submits that it is not enough to say

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[15]The Court of Appeals may feel that the burden does not stem from the use of the land asset but from the relation of the sale to the burden of the track-removal program pursuant to the D.C. Transit franchise, but this is less than clear (e.g., App. A, pp. 2a, 26a, 51a-52a, 57a-66a, 72a, 74a, 95a-96a; and App. B, pp. 149a-151a, 161a). Nevertheless, the Court also incorrectly applies its benefit-burden theory to land transactions not related to Petitioner's obligations pursuant to the franchise (App. A, pp. 74a, 96a). In any case, it is not correct at all to state that the conversion to an all-bus system was accomplished at no expense to Petitioner (App. A, p. 61a).

[16]The Commission and its predecessor, the Public Utilities Commission, had adopted this accounting practice similar to the Federal Power Commission Systems; the risk of loss as to land is placed upon Public Utilities and Natural Gas Companies by the Federal Power Commission Uniform Systems of Accounts, which have been adopted by numerous state commissions; the Public Utilities Commission of the District of Columbia (now Public Service Commission) adopted the FPC Uniform System of Accounts for Class A and B Public Utilities and Licensees as to Potomac Electric Power Company by Order No. 4727, December 29, 1960, and Order No. 5455, Docket No. P.S.C. No. EL-1, January 29, 1971.

that during the period of time in question in this case[17] actual circumstances tended to negate risk of loss as to land in a rising market, particularly in view of the uncertain market conditions in the future. In that regard, it is interesting to note that in *Smyth* v. *Ames, supra,* and other similar cases, the arguments for original cost were made by the utilities, for the assets had often been purchased at higher cost than the then prevailing market. In any case, ratemaking is prospective only and this use of hindsight has no place in the quasi-legislative process.

In sum, it is Pepco's position *arguendo* that if the case must turn upon the equities then it is only equitable for the utility to receive the benefit of the appreciation of land value at the time of transfer, so long as the land is transferred when it is reasonably no longer used and useful in the utility enterprise, which is the uncontested circumstance in this case. Pepco submits that in analyzing the specific risk of loss and burden as to land, which lie with the utility, the Court of Appeals also failed to focus upon the fact that the utility bears the risk of loss as to the entire enterprise, including as to land, insofar as the utility's relationship with its ratepayers, for the utility only possesses the right to a reasonable *opportunity* to earn a fair return from these ratepayers:

> "The revenue paid by the customers for service belongs to the company. The amount, if any, remaining after paying taxes and operating expenses including the expense of depreciation is the company's compensation for the use of its property. If there is no return or if the amount is less than a reasonable return, the company must bear the loss. Past losses cannot be used to enhance the value of the property or to support a claim that rates for the

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[17]The period in question in these proceedings from the Court of Appeals' viewpoint appears to be 1956, when Petitioner purchased the stock of Capital Transit, until the present, rather than the relatively short locked-in period between the date of the previous Commission final rate order and those presently under review. Pepco hereinafter takes issue with the resultant retroactive ratemaking.

future are confiscatory." *Board of Public Util. Com'ers* v. *New York Tel. Co.*, 271 U.S. 23, 31 (1926).

There is thus no equity in using appreciation in the value of land properly transferred to reduce the return allowance for the future, especially when the utility has failed to realize its authorized rate of return due to attrition caused by the very rise in prices which caused the value of the land to increase, and the resulting unit cost of providing the utility commodity or service.[18]

III

BY ORDERING REPARATIONS, THE COURT OF APPEALS EXCEEDED ITS JURISDICTION.

In overturning years of use of settled legal and resulting accounting principles consistently in use across several final rate orders of the Commission, the Court of Appeals resorted to retroactive ratemaking. Pepco submits that under the equitable remedy of restitution the Court has indulged in requiring reparations – the prevention of which proposition forms one of the cardinal bases for rate regulation.[19] Moreover, of real significance is that the Court of Appeals has actually directed Petitioner to return money collected pursuant to a series of final rate orders several of which were earlier upheld by that very Court.

In short, Congress did not write the power of reparations into the statute administered by the Commission any more than

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[18]It is important to note that a utility, unlike nonregulated industry, cannot abandon its utility obligations at will because it fails to earn a fair return, and thus an unconstitutional taking results where rates are set which prevent a fair return. See *Bowles* v. *Willingham*, 321 U.S. 503, 517 (1944); *Hegeman Farms Corp.* v. *Baldwin*, 293 U.S. 163, 171 (1934).

[19]See for example, *Arizona Grocery Co.* v. *Atchison, T. & S. F. R. Co.*, 284 U.S. 370, 389-390 (1932).

it did so as to the Natural Gas Act or the Federal Power Act.[20] There is no indication that Congress intended otherwise than that the power to set rates was placed exclusively in the Commission subject to normal appellate review. Pepco therefore submits that the earlier orders were finally reviewed on appeal, and thus at most the Court of Appeals could now order refunds only to the extent the holding on the land issue involved herein affects the orders before it. Profit from the locked-in periods covered by the rate orders previously held valid cannot now be used to reduce revenue, otherwise just and reasonable, collected pursuant to any other orders.

CONCLUSION

WHEREFORE, Pepco supports the Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit and urges this Court reverse the judgments of the Court of Appeals rendered in these cases in relation to the disposition of increase in the value of land assets sold or otherwise transferred from Utility Property as no longer reasonably used and useful in the utility enterprise.

Respectfully submitted,

Edward A. Caine
Of Counsel

Jack E. McGregor
Edward A. Caine
1900 Pennsylvania Avenue, N.W.
Washington, D. C. 20006

Attorneys for Potomac Electric Power Company,
Amicus Curiae
Washington, D. C.
December 26, 1973

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[20]See *Federal Power Com'n* v. *Hope Natural Gas Co.*, 320 U.S. 591,618 (1944), and *Montana-Dakota Util. Co.* v. *Northwestern Pub. Serv. Co.*, 341 U.S. 246, 254 (1951), respectively.

DEC 26 1973

SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-971

D. C. TRANSIT SYSTEM, INC., *Petitioner*,

v.

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, BLACK UNITED FRONT, WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION OF WASHINGTON GAS LIGHT COMPANY FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF FOR WASHINGTON GAS LIGHT COMPANY AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

SAMUEL S. HOLLINGSWORTH
PAUL H. FORD
Attorneys for Amicus Curiae Washington Gas Light Company
1100 H Street, N.W.
Washington, D.C. 20005

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

IN THE

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION OF WASHINGTON GAS LIGHT COMPANY FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Washington Gas Light Company (WGL) respectfully moves this court for leave to file the accompanying brief in this case as *amicus curiae*. The consent of the attorney for the petitioner herein has been obtained along with the consents of the attorneys for respondents, Black United Front and Washington Metropolitan Area Transit Commission. However, the attorney for respondent, Democratic Central Committee of the District of Columbia, refused to consent to the filing of the accompanying brief by Washington Gas Light Company as *amicus curiae*.

The applicant, Washington Gas Light Company, has an interest in this case in that it is regulated by the District of Columbia Public Service Commission (PSC). The PSC has adopted the Uniform System of Accounts prescribed for natural gas companies by the Federal Power Commission, which is similar to

the Uniform System of Accounts employed by the Washington Metropolitan Area Transit Commission. There is a substantial risk that the PSC could adopt and will be guided by the decisions handed down by the United States Court of Appeals for the District of Columbia Circuit on June 28, 1973.

WGL owns a substantial amount of real property in the Washington metropolitan area, the current market value of which exceeds its book value. Therefore, any application to it of the newly announced accounting rules would have a serious adverse impact on the Company. By altering consistently applied regulatory accounting practices and applying new rules retroactively, the court below raised a question of serious importance to WGL: Whether continued reliance can be placed on final orders of the PSC.

WGL faces severe energy problems during the decade of the seventies. It must be able to proceed on the assumption that rate orders are final—when established by the PSC and not appealed or upon final adjudication by the courts. The net result of the decision of the panel below, if applied to WGL, accompanied by the energy crisis, will be extremely unsettling to it and to its investors.

Therefore, WGL respectfully prays that the Court grant the MOTION OF WASHINGTON GAS LIGHT COMPANY FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

Respectfully submitted,

SAMUEL S. HOLLINGSWORTH
PAUL H. FORD
Attorneys for
Washington Gas Light
Company
1100 H Street, N.W.
Washington, D.C. 20005

December 21, 1973

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No.

D.C. TRANSIT SYSTEM, INC., *Petitioner*

v.

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, BLACK UNITED FRONT, WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondents.*

BRIEF FOR WASHINGTON GAS LIGHT COMPANY AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF WASHINGTON GAS LIGHT COMPANY

Washington Gas Light Company (WGL) is a corporation of the District of Columbia and the Commonwealth of Virginia. WGL is regulated by the District of Columbia Public Service Commission (PSC), which has adopted the Uniform System of Accounts prescribed for natural gas companies by the Federal Power Commission. This Uniform System of Ac-

counts is similar to the Uniform System of Accounts employed by the Washington Metropolitan Area Transit Commission (WMATC), which in turn regulates the rates of the D. C. Transit System, Inc. (Transit). Therefore, there is a substantial risk that the PSC could adopt and will be guided by the decisions handed down by the United States Court of Appeals for the District of Columbia Circuit on June 28, 1973.

WGL owns a substantial amount of real property in the Washington metropolitan area, the current market value of which exceeds its book value. Therefore, any application to it of the accounting rules newly announced in the opinion rendered last June would have a serious adverse impact on the Company.

By altering consistently applied regulatory accounting practices and applying new rules retroactively, the panel majority raised a question of serious importance to WGL: Whether continued reliance can be placed on final orders of the PSC—the regulatory commission charged with supervision of WGL in the District of Columbia.

STATEMENT OF THE CASE

These cases arise as appeals to the United States Court of Appeals for the District of Columbia Circuit of 1968 and 1970 orders of WMATC. On these appeals, a three-judge panel of the Court of Appeals, with one judge dissenting, held, *inter alia,* that WMATC's longstanding and universally accepted practice of recognizing that growth in the value of a utility's land belongs to its investors was "irrational." The panel majority held that capital gain on land belongs to its ratepayers, not to its investors. There-

fore, according to the court, a public utility's rates should be decreased by the amount of appreciation in the land once it is either sold or transferred to a non-operating status, i.e., "below the line." Moreover, the court applied a new principle of retroactivity to utilities, recalculating the income of the utility for all prior years on the basis of the new rule on capital gains and applying the difference as future income.

The panel majority rejected what it recognized as a longstanding practice of WMATC and its predecessor and held that growth in the value of land while in service should be credited to farepayers (i.e., the ratepayers). It took the position that, although at one time investors may have had a constitutionally protected interest in the growth in value of their property, more recent decisions of this court indicate that they no longer have such protection.

The panel majority applied its new rule with retroactive effect and held that not only were farepayers entitled to the appreciation on parcels that had been transferred but they were also entitled to the growth in value of all parcels of land that had been transferred to non-operating status for the past 17 years. The panel majority thereupon ordered Transit to make total restitution to its farepayers and remanded to WMATC to determine the amount and method of such restitution.

Transit filed a Petition for Rehearing and Suggestion for Rehearing En Banc to the Court of Appeals, which was denied on September 24, 1973. WGL filed a Motion for Leave to File Statement of Amicus Curiae and Statement of Amicus Curiae in Support of Petition for Rehearing and Suggestion for Rehearing En Banc, which was also denied.

REASONS FOR GRANTING THE WRIT

The decision below raises issues of great importance not only to public utilities in the District of Columbia, but to all utilities throughout the country. Although at present the lower court's decision is applicable only to Transit, the danger remains that other regulatory commissions, including the District of Columbia Public Service Commission, will in the future adopt all or part of the principles newly announced by the panel majority. The net result of the decision of the panel if applied to WGL, along with the energy crisis, will be extremely unsettling to it and to its investors. WGL must be able to proceed on the assumption that rate orders are final—when established by the PSC and not appealed or upon final adjudication by the courts—and not subject to further review and change at some unknown point in the future. It must be emphasized that the decade of the seventies is one in which this nation faces severe energy problems. Regulated companies increasingly have to turn to the public for additional financing, and this is no time to inject into the already complex investment picture the many uncertainties inherent in the decisions rendered by the panel majority.

It had been universally established by law until these decisions, that appreciation in the value of land would, at the time of sale, be credited to investors. The panel majority has now ruled as a matter of law that WMATC committed reversible error in proceeding on the basis of these time-honored legal precedents. Moreover, after a review of the equitable considerations which it says must govern, the panel majority, instead of remanding to WMATC for reconsideration in the light of those considerations, has decided for itself that the equities require the entire appreciation under re-

view to be credited to the farepayers. The panel majority has applied its new principles retroactively so as to affect rate orders which have previously been deemed valid and, in some instances, had actually been approved by that court.

If these opinions are permitted to stand, the result is a depletion in the incentive of investors to commit their funds for research and expansion in the vitally important energy utilities. Potential utility investors will be compelled to assume not only the risk that the "rules" in effect at the time of the investment may not have continuing application in the future but also the risk that the financial picture of a utility at the time of their investment is subject to complete recalculation some time in the unlimited future. The effect of the opinion of the panel majority can only be to decrease the ability of the energy utilities to raise needed capital.

We do not here take up the "merits" except to adopt the views expressed by the Petitioner. We strongly urge that the merits deserve review by this Court.

CONCLUSION

For the reasons stated above, we respectfully pray that the Court grant Petitioner's writ and reverse the opinions and judgments of the Court of Appeals in the instant cases.

Respectfully submitted,

SAMUEL S. HOLLINGSWORTH
PAUL H. FORD
Attorneys for Amicus Curiae
Washington Gas Light Company
1100 H Street, N.W.
Washington, D. C. 20005

December 21, 1973

IN THE

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OCTOBER TERM, 1973

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DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA,
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WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondents*

BRIEF OF RESPONDENTS, BLACK UNITED FRONT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

RESTATEMENT OF THE CASE

D.C. Transit Systems (Inc.) (hereinafter "Transit") (as was its predecessor Capital Transit Company, hereinafter "Capital") was not so much a public utility as it was a real estate venture (App. 51a, 52a, 57a, 58a, 60a, 61a, 62a) (App. 150a).

The grant by Congress of a franchise to Transit was conditioned on the acquisition of Capital's assets and the conversion of a streetcar-bus system to an all bus system.

This requirement caused Transit to assume an undepreciated cost of tracks and streetcars of $5 million and a cost of removal of streetcar tracks and repairing and regrading of streets of $10 million. *The cost of both of these items was later paid for by the farepayers.* (App. 54a-56a) (App. 61a) (App. 117a).

At the same time, predictably, millions of dollars worth of land formerly employed for streetcar purposes automatically lost its usefulness to Transit and was transferred out of operating status ("below the line") at book value. (App. 3a) (App. 116a) (App. 146a) (App. 150a)

Transit and its stockholders received the benefit of the "useless" land to the extent of the excess market value over book value, and knew it would receive such benefit when the company and its assets were purchased.

The Washington Metropolitan Area Transit Commission (hereinafter "Commission") based its fare setting primarily on the basis of gross operating revenues (the operating ratio method) commencing in 1960. (App. 58a-59a)

Although the Commission did also consider the undepreciated costs of track and streetcar and the cost of track removal in fixing fares (App. 61a), it failed to consider the "income" from market value of the "useless" land. (App. 5a) The Court of Appeals held this omission to be error.

ARGUMENT

(Reason for Denying the Writ)

The Court of Appeals' holding was based upon the particular and unique facts (App. 2a) of this case (App. 148a-149a) and is not a general holding relating to other kinds of assets or to other utilities.

Central to this case was the fact that Congress and Transit "knew . . . that a good part of these same properties would . . . no longer be needed for transportation purposes" (App. 150a) when the stockholders acquired the stock of Transit.

And the Court of Appeals specifically did not deal with the "kind of situation . . . that would have existed had the properties been purchased outright by [the] investors." (App. 149a)[1]

What the Court of Appeals held was that in this particular and unique fact situation "that in passing on Transit's application for higher fares, the Commission should have considered the appreciation in the value of certain of Transit's landholdings occurring while the lands were in service and prior to this transfer from operating to non-operating status." (App. 142a)

The Court of Appeals rightly declined to deal with the questions raised in the two Amicus briefs and in the petition of Transit itself (what happens if a regulatory agency takes into account the market value

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[1] As the Amicus Brief of Potomac Electric Power Company points out, page 3, footnotes # 1 and 2, there are cases pending before the Court of Appeals on appeal from the Federal Power Commission that present the issue sought to be raised by Transit and the Amicus Briefs, uncomplicated by the unique fact issues present in this case.

rise of land purchased by a utility in the normal course of business which then discards it?), because the Court's holding has no such broad application.

The Court of Appeals' decisions were based on a set of facts entirely unique to the case of Transit. The Court of Appeals decided that in passing on Transit's several fare applications it should have considered the income generated by land which everyone knew was to be removed from use for streetcar service at the time the stockholders acquired Transit. These cases do not present Fifth Amendment questions since they do not involve *all* acquisitions of property by utilities, or even all utilities, but only the unique case of *one* unique acquisition of land in the District of Columbia under unique circumstances.

CONCLUSION

For the reasons stated above, we respectfully pray that the Court deny the petition for writ of certiorari.

Respectfully submitted,

GILBERT HAHN, JR., ESQ.
700 Colorado Building
Washington, D. C. 20005
783-3344

JEAN CAMPER CAHN
1624 Crescent Place, N. W.
Washington, D. C.

Attorneys for
Respondent Black
United Front

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Supreme Court, U. S.
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DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA,

BLACK UNITED FRONT,

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondents*

MEMORANDUM OF THE DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA OPPOSING CERTIORARI

LANDON GERALD DOWDEY
1629 K Street, N.W.
Washington, D. C. 20006
Counsel to Respondent
Democratic Central Committee
of the District of Columbia

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondents*

MEMORANDUM OF THE DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA OPPOSING CERTIORARI

The three cases in which petitioner, D. C. Transit System Inc. (intervenor below) seeks certiorari were part of a group of ten cases involving the same petitioner which the United States Court of Appeals for the District of Columbia, in recognition of their interrelatedness, heard on the same day several years ago. Nine of these ten cases were subsequently decided on June 28, 1973 in six separate, but extensively cross-referenced opinions.

Opinion	Case	US App. DC No.
1	Powell v. Washington Metropolitan Area Transit Commission, reviewing Commission Order 773 entered January 26, 1968	21,750
2	Democratic Central Committee of the District of Columbia, et al. v. Washington Metropolitan Area Transit Commission, also reviewing Commission Order 773	21,865
3	Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission, reviewing Commission Orders 880 and 882 entered October 18 and October 29, 1968	22,450
4	Bebchick v. Washington Metropolitan Area Transit Commission, reviewing Commission Order 981 entered October 17, 1969	23,720
	and	
	D. C. Transit System Inc. v. Washington Metropolitan Area Transit Commission, reviewing the same order 981	23,747
5	D. C. Transit System Inc. v. Washington Metropolitan Area Transit Commission, reviewing Commission Order 984	23,958
6	Democratic Central Committee of the District of Columbia et al. v. Washington Metropolitan Area Transit Commission, reviewing Commission Order 1052 (other aspects of this order were affirmed in D. C. Transit System Inc. v. Wash-	

Opinion	Case	US App. DC No.
	ington Metropolitan Area Transit Commission, 146 US App. DC 392, 452 F2d 1321 (1971))	24,398
	and	
	District of Columbia v. Washington Metropolitan Area Transit Commission, reviewing the same Order 1052	24,415
	and	
	Black United Front v. Washington Metropolitan Area Transit Commission, reviewing the same Order 1052	24,428.

The tenth case argued with these, *Democratic Central Committee of the District of Columbia, et al.* v. *D. C. Transit System Inc.,* No. 23,795, was decided prior to the nine cases disposed of in the six opinions of June 28, 1973 listed above.

There is some question at the outset of the wisdom of undertaking a piecemeal review of this exquisitely involved complex of litigation, especially since so many of D.C. Transit's present complaints are rooted in a stormy and litigious regulatory history only partially revealed by the two opinions reproduced in petitioner's appendix (2a-7a, 35a-38a, 130a-141a, 145a *et seq.*).

Nevertheless, considering these two opinions, it clearly appears that no substantial constitutional questions are presented and that the Petition for Certiorari involves only matters of local law interpretation with which this Court is not concerned (26a-74a).

The absence of any constitutional issue is amply demonstrated by Judge McKinnon's dissenting views in No. 21,865 upon which petitioner relies so heavily.

The issue he takes with the majority is not that their treatment of land appreciation is unreasonable nor particularly novel considering the weight of precedent supporting the majority view and the lack of precedent for the distinction urged in the dissent (7a-26a, 97a-103a). His point is simply that "the policy of judicial deference to agency actions" required upholding the Commission's order (96a-97a).

Analysis of agency practice and extensive local history and precedent constitute the warp and woof of both the majority and dissenting opinions in these cases (50a-74a, 103a-126a, 141a-157a).

The Petition for Certiorari should therefore be denied.

LANDON GERALD DOWDEY
1629 K Street, N.W.
Washington, D.C. 20006
Counsel to Respondent,
Democratic Central
Committee of the
District of Columbia

Proof of Service

I hereby certify that a copy of the foregoing Memorandum of the Democratic Central Committee of the District of Columbia Opposing Certiorari was mailed, postage prepaid, this 31st day of January, 1974 to E. Barrett Prettyman, Jr., and Samuel R. Burger, Counsel to Petitioner, 815 Connecticut Avenue, N.W., Washington, D.C. 20006; Jack E. McGregor and Edward A. Caine, Counsel to Potomac Electric Power Company, amicus curiae, 1900 Pennsylvania Avenue, N.W., Washington, D.C. 20006; Samuel S. Hollingsworth and Paul H. Ford, Counsel to Washington Gas Light Co., amicus curiae, 1100 H Street, N.W., Washington, D.C. 20005; Gilbert Hahn, Jr., Counsel to Respondent Black United Front and Donald J. Balsley, Counsl to Respondent Washington Metropolitan Area Transit Commission, 1625 I Street, N.W., Washington, D.C. 20006.

LANDON GERALD DOWDEY

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WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents

PETITIONER'S REPLY BRIEF

E. BARRETT PRETTYMAN, JR.
SAMUEL R. BERGER
815 Connecticut Ave., N.W.
Washington, D.C. 20006
Attorneys for Petitioner

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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Respondents

PETITIONER'S REPLY BRIEF

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1. Respondent Black United Front asserts that the Court of Appeals' holding was "based upon the particular and unique facts (App. 2a) of this case (App. 148a-149a) and is not a general holding relating to other kinds of assets or to other utilities." "Brief of Respondents, Black United Front in Opposition to Petition for Writ of Certiorari," at 3. Respondent Democratic Central Committee of the District of Columbia relies upon essentially the same contention. "Memorandum of the Democratic Central Committee of the District of Columbia Opposing Certiorari," at 4. However, both the rationale and the impact of

these cases reach far beyond the immediate parties, which is attested to by the *amicus curiae* brief of the American Gas Association in support of the petition for rehearing in the Court of Appeals and the *amici* briefs of the Potomac Electric Power Company and the Washington Gas Light Company in support of the petition for certiorari.

Although the Court of Appeals referred to certain allegedly unique circumstances of this case, its sweeping opinion cannot be narrowly confined. The long-standing Commission rule it struck down—that growth in the value of a utility's land belongs to its investors—is essentially the same rule applied by most, if not all, federal and state utility regulatory agencies. Petition for a Writ of Certiorari, at 18. Moreover, in balancing the equities between investors and fare-payers, the Court of Appeals, as Judge MacKinnon pointed out in dissent, considered factors that apply equally to all utilities. *Id.*, at App. 100a. That the Court of Appeals' holding is not inextricably tied to the situation faced by this transit company—or by transit companies only—is further evidenced by the fact that the only precedents relied upon by the Court of Appeals involved non-transit utilities. *Id.*, at App. 17a-22a.

Furthermore, whether or not the Court of Appeals intended its holding to be narrowly focused, the impact of these cases inevitably extends much further. For however tied to these facts is its novel accounting rule, its application of an unlimited principle of retroactivity is not so anchored. By reaching back more than a decade and brushing aside numerous final administrative and judicial decrees in applying its new rule, the Court of Appeals has introduced a serious new element of uncertainty to utility financing. As

the American Gas Association stated in its *amicus curiae* brief, *supra*:

> * * * A rule which leaves matters of utility regulation to *ex post facto* determination on a case-by-case basis will have exactly the same effect on utility financing and capital structure as the most adverse decision which could be made in any case. Investors looking to the acquisition of utility company stock, whether of existing issues or in new financing, would realistically have to assume the most adverse decision before making an investment * * * . [*Id.*, at 2.]

There is nothing in the Court of Appeals' opinion that links this unlimited principle of retroactivity to the particular circumstances of this case. A prudent investor now must take into consideration, when contemplating a utility investment, that the financial statements upon which he relies are subject to judicial recalculation sometime in the unlimited future. That kind of uncertainty—by the inexorable laws of the market place—translates into higher costs for utility capital and credit at a time of an unprecedented need for those private funds. As the American Gas Association has stated, these decisions will have "significant adverse consequences for future public utility financing." *Amicus curiae* brief of American Gas Association, *supra*, at 2.

2. Respondent Black United Front also attempts to portray the Court of Appeals' holding as traceable to the conversion of Transit from a streetcar-bus system to an all-bus system, which conversion, it contends, was paid for by the farepayers and prompted the transfer of some of these properties to non-operating status. However, Respondent failed to point out that the Court of Appeals' holding applies as equally to property that is in no way related to the conversion program as it does to conversion-related property.

Thus, conversion can hardly be the factor that makes these facts in some way unique.

3. Respondent Democratic Central Committee has argued, in essence, that the Court should not review these cases because they are complicated and because, in some unspecified way, the issues raised by Petitioner cannot be dealt with without reference to other issues in other cases. "Memorandum of Democratic Central Committee," at 1, 3. The two cases for which Petitioner seeks a writ of certiorari were decided along with seven other cases involving Petitioner. Those other cases determined many other issues, some adverse to Petitioner, but none of which are involved here. The single, distinct, and precise issue raised by Petitioner—the Court of Appeals' treatment of appreciation on land—was not involved in those other cases. And it simply is misleading to imply *(id.,* at 3*)* that there is some mysterious but apparently essential information that is not revealed by the Court of Appeals' lengthy opinions in the cases in which review is sought.

4. Finally, we must re-stress the potential impact of these decisions below upon the current energy crisis. *See* Petition for a Writ of Certiorari, at 7-10. Since our petition was filed in December of last year, this crisis has deepened. Shortages have become more acute and the need for massive new private capital has become more obvious. It is even more true now than it was then that the decisions below constitute a threat to the investment of that capital, a threat that this country cannot afford at this time.

Respectfully submitted,

E. Barrett Prettyman, Jr.
Samuel R. Berger
815 Connecticut Ave., N.W.
Washington, D.C. 20006

Attorneys for Petitioner